AR27

Our Many Constituencies

- Stockholders
- Customers
- Communities
- Employees
- Educators
- Youth
- The Arts
- Retirees
- Suppliers
- Unions
- Environmentalists
- Financial Community
- Government
- Scientists
- Health Organizations
- Contractors
- Marketers
- Amateur Athletics
- Business Leaders
- Industry Groups

Corporate Profile

Phillips is headquartered in Bartlesville, Okla., where the company was founded in 1917. Bartlesville is located in the northeastern part of Oklahoma, some 50 miles north of Tulsa.

Phillips is engaged in these businesses:

- Petroleum exploration and production on a worldwide scale
- Petroleum marketing and refining in the United States
- Chemicals production and distribution worldwide

The company's activities are organized into the following groups, whose operations are discussed in this report:

- Exploration and Production
- Gas and Gas Liquids
- Petroleum Products and Chemicals

At the end of 1986, Phillips employed 21,800 people, had 109,000 shareholders and assets of $12.4 billion. The company's products and processes were licensed in 39 countries.

About the Cover

A company as large and diverse as Phillips touches those in many walks of life—employees, communities, suppliers and customers, to name just a few, in addition to its shareholders. "Our Many Constituencies," the theme of this year's cover, celebrates those who share in Phillips well-being. These constituencies not only benefit from the success of Phillips; their contributions and support have helped make Phillips a leading international concern.

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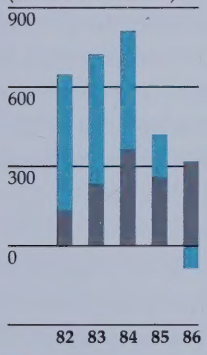
Highlights

	Millions of Dollars Except as Indicated		
	1986	1985	1984
Financial			
Total revenues	**$10,015**	15,800	15,746
Income from continuing operations	**$ 234**	596	837
Loss from discontinued operations	**$ (6)**	(178)	(27)
Net income	**$ 228**	418	810
Net income from each dollar of revenue	**2.3¢**	2.6	5.1
Income per share of common stock*			
Continuing operations	**$ .91**	2.07	1.81
Net income	**$ .89**	1.44	1.75
Interest expense	**$ 685**	846	314
Total taxes charged to income (including discontinued operations)	**$ 656**	1,625	1,661
Capital expenditures	**$ 655**	1,060	1,368
Total assets at year-end	**$12,399**	14,045	16,955
Dividends paid			
On common stock	**$ 159**	542	362
On preferred stock	**$ 24**	12	—
Cash dividends per share			
Common stock*	**$ .70**	.95	.78
Preferred stock	**$ 2.02**	1.04	—
Average common shares outstanding (in thousands)*	**227,546**	278,916	462,247

**Adjusted for three-for-one stock split in the form of a 200-percent common stock dividend effective May 31, 1985.*

Net Income
(Millions of Dollars)



	Thousands of Barrels Daily		
Operating			
Crude oil produced			
United States	**124**	154	136
Outside United States	**114**	127	132
Natural gas liquids produced	**202**	204	192
Total liquids produced	**440**	485	460
Crude oil refined	**301**	292	288
Petroleum products sold	**554**	575	507
	Millions of Cubic Feet Daily		
Natural gas produced	**1,120**	1,306	1,288

"Phillips," "the company," "we" and "our" are used interchangeably in this report to refer to the business of Phillips Petroleum Company and its consolidated subsidiaries. Where reference is made to a particular company, it is wholly owned unless otherwise stated. The company's consolidation policy is to include in financial statements the accounts of companies in which more than 50-percent interest is held, except for an insurance company and a credit company.

Driscopipe, K-Resin, Marlex, Ryton and SuperClean are trademarks for the company's products and processes named in this report.

C.J. Silas

To The Owners:

The partial recovery of oil prices we've witnessed over the past several months is an indication that the petroleum industry may be emerging from one of the most difficult periods in its history. Although still low, oil prices have improved since the collapse in 1986 that had a major economic impact throughout the world.

The sudden and severe drop in oil prices also had a serious negative effect on Phillips financial performance, although we were aided by the increasing profitability of our petroleum products and chemicals operations. Earnings for the year were $228 million, or 89 cents a share, 45 percent below 1985 earnings of $418 million, or $1.44 a share. After the elimination of nonrecurring adjustments and write-offs, our earnings for 1986 were 73 percent below the level of the previous year.

Because of the drop in oil prices and the fact that interest expenses associated with our 1985 restructuring remained high, we took a number of significant steps during the year to retain as much financial strength and flexibility as possible. We made another large reduction in the size of our work force, temporarily froze salaries, reduced other operating expenses and sharply cut back our capital spending plans. We also trimmed our common stock dividend, but took care to try to preserve a competitive yield.

1986 Accomplishments

Even though 1986 was a year of extraordinary difficulty, our cash flow remained strong, and we were able to accomplish important financial objectives. We completed the $2 billion asset sales program we undertook to reduce the debt incurred through our 1985 restructuring and met our goal of bringing total debt below the $6 billion level before the end of 1986. As a result

of this major reduction in our debt, our interest expense before income taxes dropped from $846 million in 1985 to $685 million in 1986.

During 1986 we also continued to make significant progress in lowering our costs. A key element in this effort was another sizable reduction in our work force, achieved in large part through a voluntary severance program that offered early retirement incentives and assistance in finding new jobs. We brought employment down by 14 percent in 1986, making our work force nearly 40 percent smaller than it was when we began our reduction efforts in late 1981. As a consequence of our work force reduction and other measures, operating costs and expenses have been significantly reduced.

Capital spending for Exploration and Production was sharply curtailed during the year as oil prices deteriorated. During the year, we reduced total capital expenditures to $655 million, compared with $1.1 billion in 1985, and increased our cash and short-term investment balances by $465 million.

A detailed review of our worldwide operations begins on page 6. However, we would like to call attention to several key accomplishments in 1986 that illustrate Phillips special strengths.

• Our downstream operations—Petroleum Products and Chemicals—posted one of their best years ever and contributed significantly to our earnings. While lower raw material costs were an important factor, the profitability of this part of our business can also be attributed to significant gains we've made in operating efficiency and our intensified marketing of high-value products. We achieved record sales in our U.S. plastics business for the second year in a row. Demand continued to be particularly strong for Ryton, our high-strength engineering plastic, and for polyethylene and polypropylene, versatile plastics with hundreds of different applications.

• Work began on a second production platform for the Point Arguello field off the coast of Southern California. Production from this field is expected to begin by the end of 1987. We also

Glenn A. Cox

installed a water-injection platform at the Ekofisk field in the Norwegian North Sea as one of the initial steps in a project that will prolong the productive life of this important field. In addition, we have begun a project to elevate several platforms at Ekofisk to compensate for a slow subsidence of the seabed. Because of this effort, nearly all of the natural gas we had been reinjecting into the underground reservoir to reduce the rate of subsidence can now be produced for sale to our European customers.

Strategic Objectives

While uncertainty in the oil market remains, we believe it is prudent to base our planning on the expectation that prices will remain in the $15 to $20 range for the next year or two. Consequently, we intend to focus our exploration and production efforts on the development of existing discoveries with greatest potential to enhance our near-term cash flow. Our exploration will be highly selective, with heavy concentration on lower risk, mature basins. We believe this strategy is our best approach to replacing as much of our production as possible during the current period of low prices.

In our Gas and Gas Liquids business, we are coupling a major effort to cut costs and streamline our gathering and processing system with an intensified marketing effort directed toward improving margins and increasing direct sales to consumers. We increased our reserves of natural gas available through contracts and agreements in 1986, and we have a solid position in a business that has potential for strong profitability as supply and demand come into better balance.

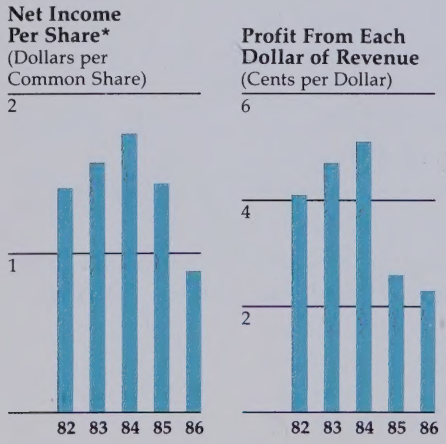
We also intend to build on the strong performance of our refining, marketing and chemicals operations. We believe our ability to produce high-value products from less expensive feedstocks will continue to provide a competitive advantage, and we are taking steps to reduce our crude oil costs still further. Our marketing emphasis will be on improving profitability through the sale of a greater percentage of premium unleaded gasoline, one of our higher-margin products.

In Chemicals, our primary objective is to facilitate the growth of our plastics business. We plan to increase production capability in our profitable K-Resin and Ryton plastics lines and to diversify our plastic products businesses.

In our research efforts, we are continuing to give major emphasis to the ways in which high technology can improve our success rate in exploratory drilling and reduce our finding costs. We're also concentrating on the development of better catalysts and chemical processes to improve our refining operations. And in view of our proven success in the development of new plastics, we are moving ahead toward the development of new polymers and advanced composite materials.

Looking Ahead

We anticipate capital expenditures of approximately $730 million this year, about a 12-percent increase over the 1986 total. Unless the current energy environment changes significantly, we expect to increase the amount of spending in our 1987 capital budget for downstream projects because of their greater potential for return on investment.



**Adjusted for three-for-one stock split in the form of a 200-percent common stock dividend effective May 31, 1985.*

Debt reduction remains an important priority, and we intend to continue this effort as rapidly as financial resources permit. However, in view of the continuing uncertainty in oil prices and the restrictions on our ability to borrow money or refinance debt at more favorable rates, we feel it's prudent to keep our cash balances at a relatively high level.

The same uncertainty that shapes our business plans also has important implications for our nation's energy future. U.S. oil production is heading downward, and America faces the prospect of relying on too few suppliers for too much of its energy. To keep oil prices at reasonable levels and moderate the impact of supply disruptions, it's vitally important for production capacity to be developed throughout the world. Our industry has a special responsibility to continue to build public support for laws, regulations and government policies that will encourage investment in long-term domestic oil and gas projects. We have long been advocating:

- The elimination of all remaining price controls and regulations on the use of natural gas;
- The removal of regulatory barriers to exploration and production here in the United States; and
- A reduction in our industry's tax burden—including repeal of the misnamed windfall profits tax—to better reflect the economic realities of today's energy market.

These issues are receiving new public attention and consideration because of a growing understanding that the strength of the petroleum industry directly affects our national security and the health of the entire economy.

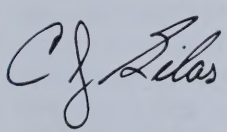
Our Many Constituencies

One of the most difficult continuing challenges of any business is the balancing of short-term and long-term interests. Our foremost objective is to generate value in the form of a return on the investment that shareholders have made in our enterprise. Generating this value on a consistent basis requires the investment of some of today's profit with an eye toward the future. And it requires attention to the needs of all of those who have a vital interest in our performance—our customers, employees and neighbors. Shareholders will benefit both now and in the future by the actions we take:

- To provide value to our customers through high-quality products and services;
- To establish a safe, challenging and rewarding work environment that will attract and retain the very best employees; and
- To conduct our operations responsibly and ethically, so that our presence is considered a benefit by our neighbors in society.

We thank our shareholders for their confidence and support. And we renew our commitment to improving our company's performance for the many people who have an important stake in our future success.

For the Board of Directors,



C.J. Silas
Chairman and Chief Executive Officer

Glenn A. Cox
President and Chief Operating Officer

February 20, 1987

Exploration and Production

The steep decline in crude oil prices was the single, most critical factor that affected Exploration and Production during the year. The average price of crude oil dropped to $14 a barrel in 1986, compared with about $26 a barrel in 1985.

To cope in this environment of sharply lower prices, the company is pursuing a strategy of developing existing discoveries to enhance near-term cash flow, while undertaking a selective exploration program with emphasis on lower risk, mature basins.

A major part of this strategy includes replacing reserves through a balanced program of exploration and development drilling, enhanced recovery and the acquisition of producing properties in areas where the company already has production operations.

During the year, there were some factors that helped mitigate the effects of sharply lower oil prices. For example, although capital expenditures were down in 1986, the company was able to secure new, high-potential acreage at lower costs than in previous years. In addition, lower drilling costs industry-wide enabled the company to continue an active drilling and development program in low-risk, mature geological areas.

In 1987 about 50 percent of Phillips capital expenditures budget will be directed to Exploration and Production. Most domestic expenditures are earmarked for major development programs under way in Southern California and the Gulf of Mexico. Overseas, major projects include continuation of the Ekofisk waterflood in the Norwegian North Sea and initial development of the Audrey gas field in the U.K. North Sea.

1986 Overview

Operating profit for Exploration and Production was $255 million in 1986, compared with $1.9 billion a year earlier. The primary reasons for the decline were sharply lower crude oil prices and lower crude oil and natural gas production.

Phillips participated in the completion of 94 exploratory wells during the year, 33 of which were productive. In the United States, discoveries were made in the Gulf of Mexico, Texas, California and Wyoming, while international discoveries were made in Nigeria and Canada.

Asset Sales

Phillips completed its asset sales program in 1986, with major Exploration and Production properties being sold in California and the U.K. North Sea. The asset sales program, which began in 1985, lowered proved hydrocarbon reserves by approximately 12 percent.

Reserves

The company's crude oil reserves declined for the year, but reserves of natural gas and natural gas liquids increased. Estimated worldwide proved reserves of crude oil decreased to 718 million barrels, a reduction of 20 percent. Proved reserves of natural gas liquids increased 14 percent to 185 million barrels. Worldwide proved reserves of natural gas were up 5 percent for the year, rising to 5.14 trillion cubic feet. Natural gas reserves from Norwegian operations were adjusted upward as a result of reducing a gas-reinjection program in the Ekofisk field. Reserves were revised downward in 1985 when gas-reinjection was initiated in an effort to reduce the rate of subsidence in the field.

Estimates of proved reserves are based upon reservoir information, technology and economics available at the end of the year. Adjustments are made to reflect changes in economic conditions, results of drilling and production and the technical reevaluation of reservoirs.

Prices

A worldwide oil glut caused prices to fall sharply during the year. Phillips average price for U.S. crude oil was down 44 percent from 1985, and prices were 47 percent lower overseas. Natural gas prices, which fell 20 percent in the United States, were up 4 percent overseas.

United States

Production of crude oil and natural gas was down for the year. The decline was caused by asset sales, lower crude oil prices and an equity redetermination which reduced the company's share of production from Alaska's Prudhoe Bay field. U.S. crude oil production was down 20 percent from 1985, and natural gas production was down 6 percent.

Capital expenditures in the United States were $214 million, down 54 percent from 1985. Exploration expenses totaled $318 million, about the same as a year earlier.

In 1986 the company completed—or participated in the completion of—522 exploratory and development wells, a 67-percent decrease from 1985.

Phillips continues to be active in the Gulf of Mexico, above. Last year, the company made two important natural gas discoveries in these waters and acquired further promising acreage. Left, work nears completion at the Gaviota terminal, scheduled to start receiving Phillips offshore California oil production by fall 1987.

By the fall of 1987, the company expects its first production from the Point Arguello field in the Santa Maria Basin offshore Southern California. In 1986 work began on a second production platform, as well as on pipeline and processing facilities. A 20-inch natural gas line and a 24-inch crude oil line will carry production from the Point Arguello field, as well as other fields in the area, to onshore processing facilities at Gaviota. Point Arguello is expected to be in full oil production by late 1989, reaching an average gross rate of 42,500 barrels a day from blocks in which Phillips has an interest. Gas production is expected to reach an average rate of 59 million cubic feet a day in 1993 from these same blocks. Phillips has an ownership in four blocks in the Point Arguello field, with interests ranging from 40 to 50 percent.

Two miles northeast of Point Arguello is the Rocky Point oil field, which Phillips continues to evaluate for possible development. An appraisal well is planned in 1987. Phillips has a 44-percent interest.

The Gulf of Mexico is another active area for Phillips, with the promise of discoveries that can be brought into production quickly. During the year, the company participated in two important natural gas discoveries offshore Louisiana. Drilling results indicate substantial gas reserves from two leases. Additional drilling is planned in 1987 to determine further the extent of the discoveries. Phillips has a 20-percent interest in one lease and a 29-percent interest in the second.

Lower oil and gas prices have reduced acreage costs as well. During the year, the company was awarded an interest in four federal leases in the Gulf of Mexico and obtained a 100-percent interest in 8,300 acres of oil and gas leases in West Texas. Late in the year, an oil discovery was drilled on the Texas acreage, and the company acquired a seismic option on an additional 46,000 acres in the discovery area.

The current economic environment also has lowered drilling costs, and Phillips has taken advantage of the situation by drilling a number of wells in mature, low-risk basins where discoveries can be brought on stream quickly. In Texas, the company participated in eight oil discoveries in the Hardeman Basin and made another oil discovery in the Texas Panhandle. Two oil discoveries were drilled in the San Joaquin Basin in California, and the company participated in another oil discovery in Wyoming's Powder River Basin.

To maintain production levels from existing fields, Phillips participated in the completion of 358 successful development wells in California, Oklahoma, Texas, Wyoming, Louisiana, New Mexico and the Gulf of Mexico. The company also completed the first phase of a $20 million carbon dioxide-injection program in southeast New Mexico that is expected to recover the equivalent of 21 million gross barrels of crude oil over a 17-year period. Phillips has a 29-percent interest in the project.

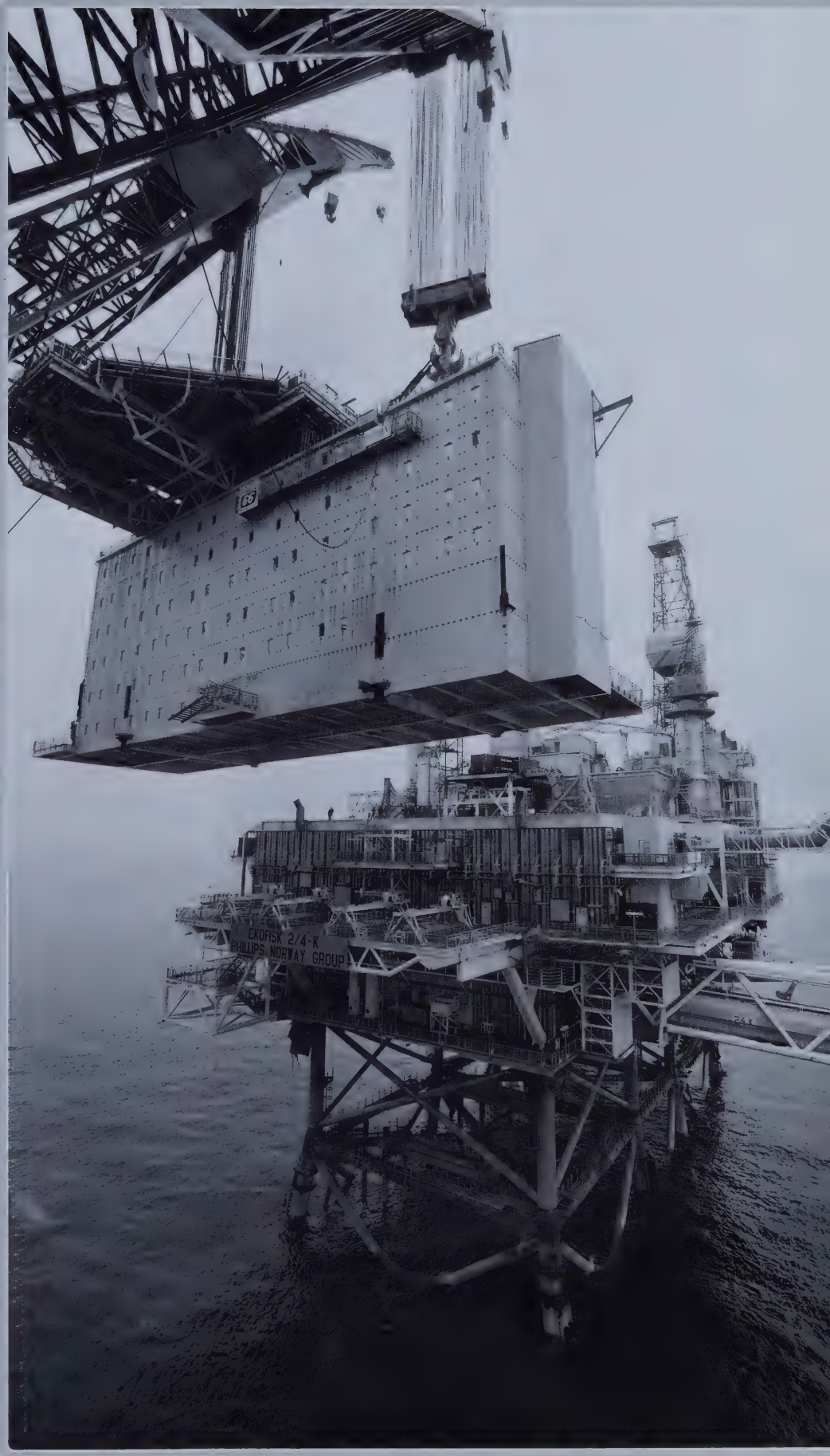
At the end of the year, 390 secondary and tertiary enhanced oil recovery projects were under way to maintain production levels from older fields. These projects account for about one-third of Phillips daily U.S. production.

In Alaska, production from Prudhoe Bay averaged 15,700 barrels of oil a day. In late 1985, an equity redetermination caused Phillips share of production to be reduced from 27,000 barrels of oil a day to the current level. Phillips production will increase to 25,000 barrels of oil a day in September 1987. The company is contesting the redetermination.

Norway

Production of crude oil and natural gas liquids was down from the Greater Ekofisk Development in the Norwegian North Sea. This was primarily the result of the natural decline that occurs as fields mature and a labor strike that shut in production for 21 days in April. The company's 37-percent share of production averaged 52,300 barrels of crude oil a day, down 17 percent from 1985. Natural gas liquids production averaged 9,800 barrels a day, down 19 percent from the previous year.

Natural gas production was also down for the year, averaging 217 million cubic feet a day, a 34-percent decline. Production was adversely impacted by a gas-reinjection program that was under way most of the year to reduce the rate of subsidence in one of the seven fields that make up Greater Ekofisk. The seafloor has subsided about 12 feet since the Ekofisk field began producing in 1971. Late in the fall, the company reduced the amount of gas being reinjected and began work on an alternate solution—a plan to elevate six steel platforms on the field by 20 feet. The operation is expected to be complete in the third quarter of 1987. Modifications to a million-barrel storage tank and processing facility also are planned to compensate for the effects of subsidence.



Living quarters, right, are hoisted to the deck of the Ekofisk water-injection platform, scheduled to go into operation during 1987. The waterflood will recover additional reserves from the Ekofisk field. Above, the Maureen field in the U.K. North Sea is another major source of Phillips oil production.

Phillips is strengthening its gas position offshore the United Kingdom. Development at the Hewett-area fields, above, is expected to increase ultimate recoverable gas reserves. Another field, nearby, is under development, with initial gas shipments scheduled for 1988.

Steps also are being taken to extend the producing life of the Ekofisk field, the central field in the Greater Ekofisk Development. A water-injection platform was installed during the year and is expected to go into operation in the third quarter of 1987.

For several years, the company has been making use of the spare capacity in the Greater Ekofisk transportation and processing system by entering into agreements with other producers to process and transport their production. In 1986 agreements were signed to handle oil and natural gas from the Ula field and natural gas from the Tommeliten field.

During the year, the company applied for an interest in a block in the Haltenbanken area offshore the western coast of the country.

United Kingdom

Phillips 34-percent share of production from the Maureen field in the U.K. North Sea was 22,600 barrels of oil a day, down 5 percent from a year earlier.

The company continues to study the feasibility of developing the J-Block field, located south of Maureen. During the year, two successful appraisal wells were completed and a three-dimensional seismic survey undertaken. Phillips is operator and has a 33-percent interest.

A number of steps were taken during the year to improve the company's natural gas position off the southeast coast of Great Britain. A $45 million development program, which will be completed in 1987, is expected to increase ultimate gas recovery from the Hewett-area fields by 50 billion gross cubic feet. Also, under terms of a new sales contract, Phillips and co-venturers will receive a higher price for Hewett gas delivered to the British Gas Corporation. During the year, Phillips 19-percent share of production from Hewett averaged 54 million cubic feet a day, compared with 55 million cubic feet a day in 1985.

In 1986 an onshore processing terminal at Bacton was modified to process an additional 240 million cubic feet of natural gas a day and 480 barrels of condensate a day. The facility will process Hewett gas, as well as gas produced by other operators.

Also off the southeast coast of Great Britain, the company is moving ahead with the development of the Audrey natural gas field. Phillips is operator and has a 23-percent interest. Deliveries to the British Gas Corporation are scheduled to begin in 1988.

Other Producing Areas

In Nigeria, Phillips share of production averaged 21,800 barrels of oil a day, down 9 percent from the previous year. Production is expected to benefit from a gas-reinjection program that began late in 1986. Also late in the year, the company discovered a new oil field. Development drilling is planned in 1987.

Phillips share of production from the Espoir field offshore Cote d'Ivoire averaged 4,900 barrels of oil a day, down 9 percent from 1985.

In Canada, Phillips share of production averaged 3,900 barrels of oil a day and 29 million cubic feet of natural gas a day. Oil production was down 2 percent from the previous year, and natural gas production was down 6 percent. In 1986 Phillips drilled six successful exploratory wells in the province of Alberta.

In 1986 the company's share of production from three fields in Egypt averaged 2,100 barrels of oil a day, compared with 2,500 barrels a day in 1985. In the second quarter of 1987, a new pipeline will begin carrying crude oil production from the Umbarka field to the Western Desert Pipeline. The new pipeline will lower transportation costs on existing production and enhance the potential for developing additional production.

Offshore Indonesia, production began during the year from a field in the Kakap block and averaged 1,600 net barrels of oil a day. A development plan is being considered for a second field in the same area. Phillips has a 15-percent interest in both fields.

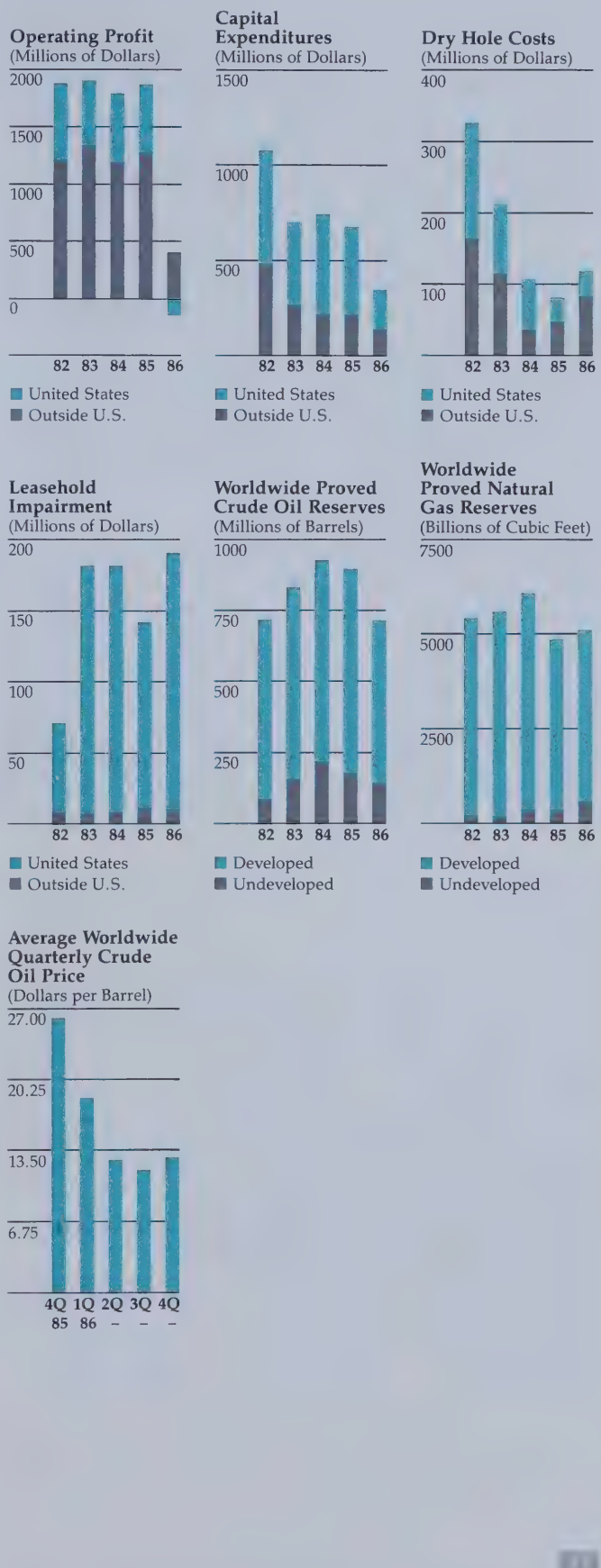
In Argentina, net production from the Mendoza Field Complex averaged 4,900 barrels of oil a day, compared with 4,500 barrels a day the previous year.

Other Exploratory Areas

Late in the year, the company began drilling an exploratory well on a newly acquired block in the South China Sea offshore the People's Republic of China. The well is immediately south of a block where Phillips discovered an oil field in 1985. Additional drilling is planned in 1987. Phillips is operator and has a 50-percent interest in both blocks.

The company enhanced its drilling prospects overseas with the opportunity to participate in the drilling of exploratory wells in Pakistan and the Netherlands in 1987.

Exploration and Production Statistics



Downstream Operations

The company's downstream operations—Petroleum Products and Chemicals—were the largest contributor to operating profit for the year.

Although these businesses benefited from lower crude oil and energy costs, a number of equally significant factors led to higher earnings. Chief among these was the company's state-of-the-art processing system, which transforms lower cost crude oils into higher value products. This system is the result of a $1 billion program, completed in the early 1980s, to modernize the company's two largest refineries. Expenditures made in previous years at other facilities also continued to improve operating efficiencies and benefit earnings. In addition, earnings improved as a result of lower transportation expenses and a general cost-cutting program.

Employees of the Borger Refinery and NGL Process Center set an all-time refining industry safety record in 1986 by completing more than 9 million employee-hours without a lost-time injury.

Petroleum Products

Nineteen eighty-six was one of the best years ever for Petroleum Products. Not only was operating profit up, but Phillips refineries were the safest in the industry, and the company again was recognized as the best supplier to independent marketers.

A major factor in profitability was the company's ability to process low-cost crude oils, while achieving one of the industry's highest percentages of automotive gasoline production per barrel of crude runs. Phillips strong position in natural gas liquids enabled the company to blend less costly liquids into motor fuel, thereby increasing gasoline production at minimal cost. Profitability also improved as a result of selling higher volumes of Phillips 66 branded products.

In the coming year, the company intends to build on the same factors that made 1986 a successful year. The ability to produce high-value products from cheaper grades of crude oil will play a large part in this strategy.

In addition, the company will keep working to hold down crude costs to its refining operations. To support this effort, Phillips posted crude oil prices will continue to be kept in line with spot market prices, which are generally lower. The company also plans to keep purchasing as much as 15 to 20 percent of its crude needs on the spot market, where it can take advantage of any fluctuations in price.

In marketing, efforts will continue to increase the sales of branded products. A major priority will be to increase sales of premium unleaded gasoline, one of the higher margin products, to 15 percent of total gasoline sales, compared with 9 percent currently.

In order to increase sales of high-value products, Phillips plans to replace an alkylation unit at its Sweeny, Texas, refinery, beginning in 1987. This will enable the company to increase octane by processing a higher volume of low-value by-products into higher octane blend stocks than is currently possible. By the same token, the unit will allow aromatics now being used for gasolines to be sold as petrochemical products.

In 1987 about 14 percent of total capital expenditures will be directed to Petroleum Products.

1986 Overview

Operating profit for Petroleum Products was $458 million, compared with $342 million in 1985. The improvement was due primarily to lower feedstock costs and improved operating efficiencies.

Motor fuel sales were up for the third straight year, primarily as a result of higher sales of Phillips 66 brand products. Compared with 1985, sales of branded products were up 14 percent to the company's independent marketers, while sales rose 32 percent from Phillips own retail outlets. U.S. sales of distillates also continued to improve in 1986.

U.S. sales of natural gas liquids products were down 14 percent from 1985. This was caused primarily by greater internal use of natural gas liquids as feedstocks.

Combined sales volumes of turbine fuel and aviation gasoline remained strong for the year. Phillips is a leading supplier of aviation fuel to fixed-base operators.

Asset Sales

As part of the asset sales program to reduce debt, Petroleum Products sold a crude oil tanker, an East Coast marketing subsidiary and an interest in a U.S. pipeline company. The company also sold its interest in a bitumen refinery in Great Britain. These sales are expected to have minimal impact on future earnings.

Feedstock Supplies

Crude oil runs were up in 1986. U.S. crude oil accounted for 81 percent of the company's crude runs, down 7 percent from the previous year. Natural gas liquids processed in Phillips facilities were up slightly for the year.

Refining

Phillips operated its U.S. refineries at 100 percent of rated capacity, compared with an industry average of 83 percent.

The cost of crude oil delivered to the company's three U.S. refineries was 46 percent lower than in 1985, reflecting the general decline in crude oil prices and greater reliance on lower priced spot-market purchases. High-sulfur crude oil, a low-cost grade of crude oil from which the company produces high-value products, accounted for 65 percent of the crude processed.

Phillips 66 SuperClean unleaded and unleaded premium gasolines were introduced throughout the company's 34-state marketing area in 1986. Formulated to keep fuel injectors and carburetors clean, SuperClean gasolines have more continuous cleaning power than previous Phillips gasolines.

During the year, Phillips expanded its involvement in crude oil trading in order to increase the company's responsiveness to rapidly changing crude oil and product prices.

The cost of natural gas liquids was down for the year, falling 45 percent. Natural gas liquids processed averaged 201,000 barrels a day, up 3 percent from 1985.

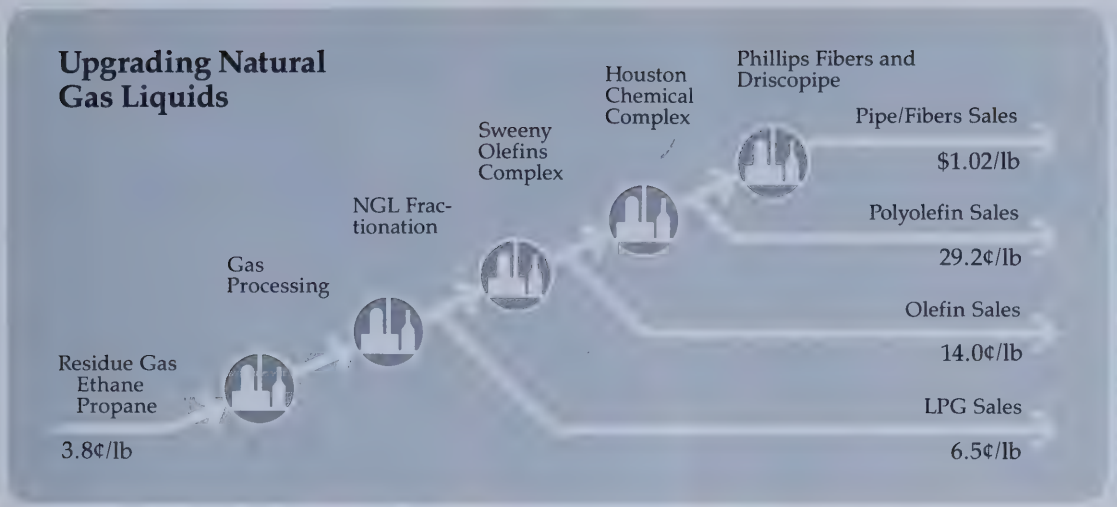
A major contributor to improved efficiencies was the company's outstanding safety record. Phillips refineries have been recognized as the safest in the industry by the National Safety Council. In 1986 the company's Borger, Texas, refinery set an all-time record for safety with more than 9 million employee-hours worked without a lost-time injury.

Marketing

Phillips continued to enhance the image of the Phillips 66 brand, working with independent marketers to improve service and appearance at retail outlets. In addition, the company stepped up its direct marketing efforts by acquiring 17 high-volume stations in metropolitan areas where there was opportunity to make the Phillips 66 brand more visible. As part of the brand-improvement program, the company also built or renovated 40 stations, all featuring the latest in station design and automation. These stations not only provide a good return on investment but also set the standard for what the company expects from its independent marketers in the area.

During the year, Phillips introduced two new unleaded gasolines, trademarked SuperClean. The gasolines have high detergent content and are designed to keep port fuel-injectors, as well as carburetors, running clean.

For the second year in a row, Phillips was voted best supplier to independent marketers by the Petroleum Marketers Association of America.

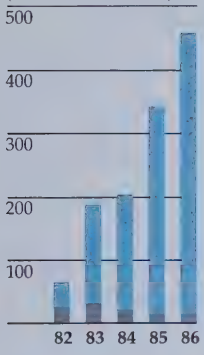


This diagram shows how value is added to raw materials, such as ethane and propane, as they go through various levels of processing.

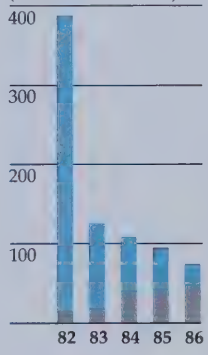
Prices are based on average 1986 data. Butanes and pentanes, used in the production of automotive gasoline, are excluded.

Petroleum Products Statistics

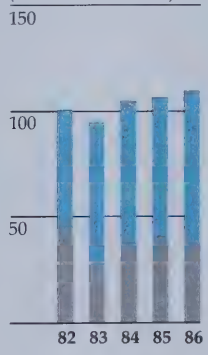
Operating Profit
(Millions of Dollars)



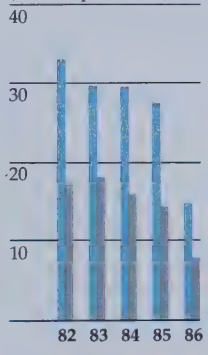
Capital Expenditures
(Millions of Dollars)



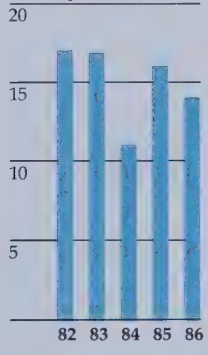
Refinery Crude Oil Runs
(Millions of Barrels)



Average Cost of Refinery Feedstocks
(Dollars per Barrel)



Margin of Motor Fuel Sales Price Over Crude Oil Feedstock Cost
(Cents per Gallon)



Refinery Crude Oil and Natural Gas Liquids Capacities and Runs—Thousands of Barrels Daily

	Crude Oil		Natural Gas Liquids	
	Capacity	Runs	Capacity	Processed
1986				
Sweeny, Texas	**175**	**175**	**86**	**89**
Borger, Texas	**100**	**103**	**95**	**86**
Woods Cross, Utah	**25**	**23**	—	—
Conway, Kansas	—	—	**42**	**26**
	300	**301**	**223**	**201**
1985				
Sweeny, Texas	175	169	86	88
Borger, Texas	100	99	95	86
Woods Cross, Utah	25	24	—	—
Conway, Kansas	—	—	42	21
	300	292	223	195

Major Products Produced Per Barrel of Crude Runs

	1986	1985
Automotive gasoline	**63%**	61
Aviation fuels	**14**	12
Distillates	**28**	29
Residual products	**1**	2

Phillips blends natural gas liquids into automotive gasoline, and this enables the company to have one of the highest percentages of gasoline produced per barrel of crude oil runs.

Chemicals

Phillips Chemicals business is a leader in return on assets among integrated oil companies. Over the past five years, the company has reshaped its operations to fit economic conditions, selling or shutting down those businesses that no longer fit current strategy and focusing on businesses that complement each other by virtue of feedstock position or technology.

A major strength of Chemicals results from Phillips being an integrated oil company with both petroleum refining and natural gas liquids operations. These operations not only meet important feedstock requirements of Chemicals but also give the company the benefit of higher margins for products as they are upgraded from raw materials to finished products.

Looking to the future, the company will continue to focus its efforts on business lines where Phillips is firmly established, where it has strong technical and research expertise and where there is opportunity for future growth.

In the plastics arena, the company plans to expand its K-Resin and Ryton lines and diversify its plastic products businesses. Another growth area will be catalysts, where Phillips plans to continue to produce and market new catalysts for the petroleum and petrochemical industries.

In 1987 approximately 14 percent of the company's capital expenditures budget will be directed toward Chemicals.

1986 Overview

Operating profit from Chemicals was $299 million in 1986, compared with $219 million a year earlier. Profits benefited from lower feedstock costs, primarily crude oil and natural gas liquids. Higher plant utilization rates and improved operating efficiencies also contributed to profits.

Asset Sales

As part of the company's asset sales program, the company disposed of its fertilizer business and sold its equity interest in an olefins and polyolefins facility in Belgium. The company also sold its interests in carbon black businesses in Europe, North America and South Africa. These sales are expected to have minimal impact on future earnings.

Basic Petrochemicals and Specialty Chemicals

Production levels reached record highs for olefins, and the company restarted previously idled capacity to meet increased demand. The main olefins Phillips produces are ethylene and propylene, major feedstocks in the manufacture of plastics.

Revenues were up for specialty chemicals, and margins improved as a result of operating efficiencies and lower raw material costs.

A worldwide drilling slump caused earnings to decline for Drilling Specialties Company, which manufactures and markets drilling mud additives and other oil field chemicals.

A plant expansion completed late in 1985 enabled Catalyst Resources Inc. to increase sales volumes. This subsidiary manufactures polymerization catalysts for the plastics industry.

Plastics

The company's U.S. plastic resins and products businesses had record sales volumes for the year, and worldwide production reached its highest level ever. To meet increased demand, an expansion of the company's polypropylene facilities was under way at the end of the year at the Houston Chemical Complex. When the expansion is completed in 1987, capacity will be increased by 170 million pounds, bringing total capacity to 420 million pounds. Phillips manufactures four major plastic resins: Marlex polyethylene, produced by the world's most widely used high-density process; Marlex polypropylene, used in synthetic fibers and other plastic products; Ryton, an engineering plastic with heat and corrosion resistance; and K-Resin, a clear plastic used in disposable containers and packaging.

Sales volumes were up slightly for Phillips Driscopipe Inc., a subsidiary that manufactures polyethylene pipe for the oil and gas industry, municipalities and fiber optics businesses. The company significantly increased sales to industrial and municipal markets, offsetting a decline in oil field applications. An expansion was completed during the year at a plant in Watsonville, Calif.

Several new advanced composites based on Ryton plastic were introduced during the year. Advanced composites, often referred to as synthetic metals, are being used in the aerospace, defense and industrial markets.

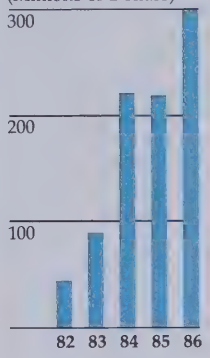
Phillips Fibers Corporation, a wholly owned subsidiary, achieved record sales volumes in 1986 for the fourth year in a row. Demand continued to be strong for polypropylene fibers and for nonwoven fabrics in textile and civil engineering markets.

Work to expand Phillips polypropylene facilities near Houston is scheduled for completion late in 1987. The project will boost production capacity there by almost 70 percent. Above, sections of Driscopipe are shipped to market from the Watsonville, Calif., plant. Driscopipe sales held their own last year, despite a downturn in oil-field orders.

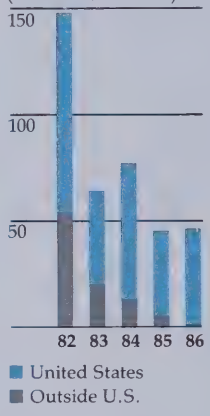
An order of Phillips catalysts is readied for shipping at the company's Bayport, Texas, plant. Sales volumes were up last year for these catalysts, used primarily in the manufacture of plastics.

Chemicals Statistics

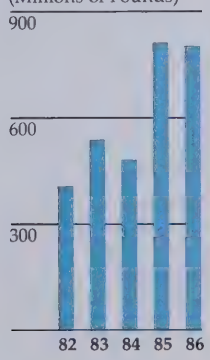
Operating Profit
(Millions of Dollars)



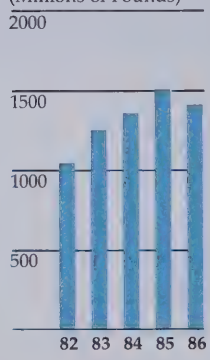
Capital Expenditures
(Millions of Dollars)



Ethylene Sales
(Millions of Pounds)



Polyethylene Sales
(Millions of Pounds)



	Millions of Dollars				
	1986	1985	1984	1983	1982
Operating Revenues					
Basic petrochemicals and specialty chemicals	**$ 748**	1,097	1,092	998	935
Plastic resins	**622**	625	638	572	508
Synthetic fibers	**146**	139	127	120	97
Plastic pipe	**87**	91	93	87	64
Rubber chemicals*	**61**	187	214	234	308
Consumer products*	**—**	—	—	46	202
Fertilizers*	**6**	80	92	95	139
Other sales and services	**28**	47	95	103	103
	$1,698	2,266	2,351	2,255	2,356

**Operations sold.*

People

Phillips people continued to adapt to changing conditions in the company and the oil industry in general. Streamlining and consolidations, made to improve efficiencies in the operating groups and staffs, also broadened the roles of many employees. In addition, productivity improved significantly as employees became more involved in decision-making and undertook only those projects that reflect the company's highest priorities and objectives.

Employment

At the end of the year, Phillips employed 21,800 people, down 3,500 from 1985. Approximately 2,600 people took advantage of a special separation program, which offered incentives such as outplacement services and enhanced retirement benefits. The remainder of the work force reduction came as the result of normal attrition or by the sale of assets. Over the past five years, Phillips has reduced total employment by 37 percent.

Women and minorities accounted for 16 percent of the company's U.S. work force in 1986. Women held 5 percent of the managerial jobs, and minorities held 7 percent.

Employee Participation

Phillips Suggestion Plan ranked first in the petroleum industry for savings per employee and fourth among all companies of 6,000 or more employees. The rankings were made by a national organization that represents all suggestion plans.

Although Phillips work force was smaller, participation in the company's Suggestion Plan continued at a strong pace, with an average of more than 80 suggestions submitted for each 100 eligible employees. First-year tangible savings from suggestions were $15 million, compared with $21 million in 1985. The total amount paid to employees for their suggestions was $1.3 million in 1986, the same as a year earlier. During the year, the company made its first $50,000 suggestion awards, the highest given. Three suggestions received the maximum award.

Participative Action Teams continued to contribute to efficiency and profitability. These teams, which meet regularly to solve work-related problems, encourage innovation and improve understanding of business operations and management problems. Since the program began in 1981, Participative Action Teams have reduced costs by approximately $11 million.

Safety

In 1986 Phillips refining operations were the safest in the industry, with the Borger, Texas, refinery setting a new record of 9 million employee-hours without a lost-time accident. Overall, Phillips safety record remained in second place among major oil companies. Recordable injuries were 8 percent lower for the year, with lost workday cases remaining the same. Vehicle accidents were reduced 25 percent, and property loss was down 60 percent. An accident near a gas-gathering system resulted in one employee death during the year.

Sweeny refinery employees Jim Hensley, left, and O.D. Campbell shared the company's top suggestion award, $50,000, in 1986. Their suggestion led to a major increase in ethylene output.

Technology

Phillips continues to support its main businesses through strong research and development and greater reliance on high technology. In addition, the company is committed to developing new markets for its research accomplishments and has established a special organization to test-market new products and processes. One example of a product successfully test-marketed by this organization is Phillips line of advanced composites, which were placed in the company's Chemicals operations in 1986 for full commercialization.

Exploration & Production

A team of experts in the areas of technical computing, geoscience and drilling and production research work together to meet the needs of the company's Exploration and Production organization.

The study of oil and gas reservoirs, critical to a successful exploration and production program, continues to be a major thrust. During the year, new methods were developed to measure rock properties in the Ekofisk reservoir in the Norwegian North Sea. These measurements will provide information necessary to optimize future oil and gas production. In addition, the company is working to increase production rates from individual wells in the North Sea by improving acid-fracturing techniques. Sophisticated computer technology was installed at key production areas during the year to simulate reservoir conditions and better predict future production rates.

Phillips geoscientists continued to make progress in reducing petroleum finding costs by utilizing more reliable methods to determine rock properties from geological and geophysical data. To improve success rates in exploratory drilling, advanced computer technology was employed that improves the seismic images of complex formations.

The use of technical data bases is becoming increasingly important in exploration and development, and a strong effort is under way to develop integrated systems and programs to make data more readily accessible and useful.

Petroleum and Chemical Processes

Phillips researchers continue to develop new processes to enhance the profitability of the company's downstream businesses.

To aid refining operations, a catalyst bed support for upgrading crude oil was developed and placed in service at the company's Sweeny, Texas, refinery. New procedures also were developed that allow the company to evaluate more rapidly the catalysts used in refining.

To reduce the problem of clogged fuel injectors in late-model cars, a new line of detergent unleaded gasolines was formulated and tested. The gasolines, introduced later in the year under the Phillips 66 SuperClean brand, have higher levels of detergent additives than previous Phillips gasolines.

The company improved its efficiency in handling solid waste materials by making modifications to its hazardous waste incinerator, located at research facilities in Bartlesville, Okla. The incinerator, the first to receive a federal permit, has destroyed more than 3 million pounds of hazardous waste since mid-1984. The company plans to apply for permits for commercial-size incinerators at its two Texas refineries in 1987.

During the year, Phillips researchers developed a process that uses a new family of absorbents to reduce the emissions of sulfur oxides from gas-processing plants. The absorbents are reusable and reduce emissions well below mandated environmental limits. The proprietary process requires low capital investment and can be used in remote gas field locations as well as in normal refinery operations. Sulfur oxides are a major component of acid rain.

Polymers and Materials

The company continued to build on its expertise in plastics development. During the year, a unique hydrocarbon monomer was developed that, when polymerized, yields a clear, tough and thermally stable plastic that can be used for a variety of molding, film and fiber applications. In the area of high-density polyethylene, a new polymer was developed that is both strong and corrosion-resistant. A new process also was developed for manufacturing rotomolding resins, used in the production of large chemical storage tanks, trash containers and sporting equipment.

In the area of advanced composites, a new polyarylene sulfide resin was produced and converted into a composite material with unique properties for the aerospace industry. The

composite is resistant to high temperatures and to the corrosive effects of a wide variety of aircraft fuels, hydraulic fluids and lubricants.

Technology was developed to produce three new organosulfur chemical products that can be used in rocket binders, surfactants and lubricant additives.

In another development, the company discovered a low-cost process to produce ceramic powders, which in finished parts can withstand temperatures of 2000 degrees F. These powders are expected to find commercial application in electronics and heat engines.

A number of steps were taken to enable the company to analyze products more efficiently. In refining, the company's newly developed laboratory robot was installed at the Borger, Texas, refinery to perform routine analytical tests. In addition, a method was developed to determine more accurately the components of natural gas liquids, an important factor in contract agreements with producers.

Biotechnology

Phillips continues to use its fermentation and yeast recombinant technology to produce proteins that have potential use in the pharmaceutical industry. Among these products are tumor necrosis factor, which is a natural protein with a potential for treating cancer, the antigen for Hepatitis B vaccines and streptokinase for cardiovascular treatment.

Phillips has joined two German pharmaceutical companies to produce and market certain pharmaceuticals, including a protein used in the diagnosis of human dwarfism.

New developments continue to be made in developing pheromones, environmentally safe substances that can be used to control agricultural pests. A pheromone developed by Phillips researchers to aid cotton farmers was marketed during the year, and four other pheromones are expected to be commercial in the near future. Provesta Corporation, a wholly owned subsidiary, produces and markets many of Phillips biotechnology products and processes, including pheromones, synthetic proteins and enzymes.

Patents

Phillips received 222 U.S. patents and 286 foreign patents during 1986. At the end of the year, the company held 5,161 active U.S. patents, the most of any oil company. Licensing revenue was up slightly from 1985.

A process for producing a new hydrocarbon monomer entered the pilot plant stage at Phillips research facilities in Bartlesville during the year. The monomer, expected to find commercial use in certain new-age plastics, offers improved performance in high-temperature applications.

Corporate Citizenship

As the cover of this annual report demonstrates, the people who share in the success of Phillips Petroleum Company are widely divergent in their backgrounds and interests. They range from the citizens of the communities where the company operates to the stockholders, who own the company. They include the independent marketers who sell Phillips 66 products and the customers who buy them. Phillips is its retirees, who have laid the foundation for the future, and employees who will build on it.

The company is committed to each of its constituencies. One measure of that commitment is the amount of charitable dollars Phillips contributes each year to help provide for the overall well-being of the people who share in the company's success. In 1986, $7.4 million was given to organizations involved in youth, civic, cultural, educational, health and welfare activities.

Young ballerinas polish their talents at the Oklahoma Summer Arts Institute, one of many fine arts organizations supported by Phillips.

Community Involvement

Phillips philanthropic activities benefited various groups, such as a senior citizens' activity center, a summer arts camp for talented arts and humanities students, an economics education program for clergy and flood relief for a community.

Amateur swimmers and divers continued to benefit from the company's support of these two sports. During the year, the company sponsored clinics and national championships for young people. The company has been national sponsor of United States Swimming since 1973 and United States Diving since 1979.

Educational Support

Approximately $4 million of the company's contributions went to education and educational films. Some 450 colleges and universities benefited from this support.

The company's newest film series, "Challenge of the Unknown," was distributed during the year to schools across the country. The seven-part series seeks to help students understand the relevance of mathematics. The films were developed for math students in elementary, junior and senior high schools and include teaching materials for instructors.

The company's two other film series, "American Enterprise" and "The Search for Solutions," are the most widely viewed educational films in the United States.

Environmental Protection

Capital expenditures of $28 million were approved during the year to protect and improve the environment; another $109 million was spent to operate and maintain existing environmental control systems. Among the major projects completed were solid waste disposal facilities at the Borger, Texas, refining and petrochemical complex and a system for handling oily waste at the Borger refinery.

Energy Conservation

A companywide energy conservation program saved the equivalent of 300,000 barrels of crude oil during the year. This is the 14th consecutive year that the company's rate of energy use has been reduced. Since 1973, when the program was first initiated, the company has reduced its rate of energy use by 33 percent. The efficient operation of existing facilities and state-of-the-art design of new facilities continue to be important factors behind the company's ability to meet its energy conservation objectives.

Financial Review 1986

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Oil and Gas Operations

Consistent with Financial Accounting Standards Board (FASB) Statement No. 69, "Disclosures about Oil and Gas Producing Activities," and in accordance with regulations of the Securities and Exchange Commission (SEC), the company is making certain disclosures about its oil and gas exploration and production operations. While this information was developed with reasonable care and disclosed in good faith, it is emphasized that some of the data are necessarily imprecise and represent only approximate amounts because of the subjective judgments involved in developing such information. Accordingly, this information may not necessarily represent the present financial condition of the company or its expected future results.

HIGHLIGHTS

Consolidated net income for 1986 was $228 million, compared with $418 and $810 million for 1985 and 1984, respectively. Minerals operations were discontinued in 1985, resulting in a charge of $178 million to earnings. Revenues for 1986 were $10.0 billion, compared with $15.8 billion for 1985 and $15.7 billion for 1984.

The decline in crude oil prices was the single, most significant factor that affected the company's performance during 1986. As a result, the company took a number of actions to enhance its financial position to meet the challenge of operating in an environment of reduced and unstable oil prices and a changing economy. The most significant were as follows:

- The company successfully completed its asset disposition program, which it began in 1985 as part of a major debt-reduction program.
- The company restructured its primary retirement plan, which resulted in $379 million of surplus funds being returned to the company.
- The company offered a special separation program, which reduced the work force by approximately 2,600 and lowered operating costs. Total employment is down 37 percent from 1981.
- Phillips reduced total debt by $839 million in 1986 to $5.9 billion. Total debt has declined $2.7 billion from a peak of $8.6 billion since the company's Exchange Offer in 1985, when the company exchanged $4.5 billion of debt securities for 72.58 million shares of common stock. The debt reductions were achieved through sales of assets, the retirement plan restructuring, cost reductions and adjustments in capital spending.

RESULTS OF OPERATIONS

Income from continuing operations for 1986 was $234 million, compared with $596 and $837 million for 1985 and 1984, respectively.

The primary factors behind the 1986 decline in income from continuing operations were lower worldwide crude oil and natural gas sales prices and production, lower sales prices for petroleum products and natural gas liquids, and higher special separation program expenses. These negative factors were partly offset by lower feedstock and operating costs for the company's downstream operations, lower natural gas purchase costs, the gain from restructuring the company's retirement plan and lower interest expense. The decline in income was also offset by lower crude oil excise taxes in 1986 and foreign currency transaction gains in 1986 versus losses in 1985.

The following demonstrates the significant change in 1986 average sales prices, compared with 1985: U.S. crude oil, $13.83 per barrel, down 44 percent; foreign crude oil, $14.35 per barrel, down 47 percent; U.S. natural gas, $1.70 per thousand cubic feet, down 24 percent; foreign natural gas, $3.87 per thousand cubic feet, up 4 percent; U.S. natural gas liquids, $7.89 per barrel, down 40 percent; automotive gasoline, $.49 per gallon, down 40 percent; and distillates, $.48 per gallon, down 38 percent.

For 1986, the company's worldwide crude oil production was down 15 percent, natural gas production was down 14 percent, and production of natural gas liquids was about the same as 1985. Contributing to the decline in crude oil and

Summary of Income

Years Ended December 31	Millions of Dollars		
	1986	1985*	1984*
Petroleum Exploration and Production			
United States	**$ (146)**	606	610
Outside United States	**401**	1,273	1,187
	255	1,879	1,797
Gas and Gas Liquids	**(8)**	291	344
Petroleum Refining, Marketing and Transportation			
United States	**443**	327	182
Outside United States	**15**	15	21
	458	342	203
Worldwide Petroleum	**705**	2,512	2,344
Worldwide Chemicals	**299**	219	221
Corporate and Other	**(312)**	(778)	(447)
Income from Continuing Operations before Income Taxes	**692**	1,953	2,118
Income Taxes	**458**	1,357	1,281
Continuing Operations	**234**	596	837
Discontinued Operations	**(6)**	(178)	(27)
Net Income	**$ 228**	418	810

**Effective January 1, 1986, certain corporate expenses previously allocated to operations were included in Corporate and Other. Accordingly, 1985 and 1984 operating results are restated.*

natural gas production were the sale of producing properties, lower sales prices and an equity redetermination of the company's share of production from Alaska's Prudhoe Bay field.

Petroleum Exploration and Production

Pretax earnings for 1986 were $255 million, compared with $1.9 billion in 1985 and $1.8 billion in 1984.

Domestic operations showed a pretax loss of $146 million, compared with pretax earnings of $606 million in 1985 and $610 million in 1984. The decrease in 1986 was due primarily to lower sales prices and production for both crude oil and natural gas and higher depreciation, depletion, amortization and retirements. These negative factors were partly offset by lower lifting costs and lower crude oil excise and production taxes. The increase in depreciation, depletion, amortization and retirements was due primarily to a reduction in certain estimated oil and gas reserve quantities, since previously estimated recovery was no longer considered economically feasible due to the dramatic decline in oil and gas prices.

Pretax earnings outside the United States were $401 million in 1986, compared with $1.3 billion in 1985 and $1.2 billion in 1984. The decrease was due primarily to lower crude oil sales prices and production, and lower natural gas production. Natural gas production was adversely impacted by a gas-reinjection program that was under way most of the year to reduce the rate of subsidence in the Ekofisk field, one of the fields that make up Greater Ekofisk offshore Norway.

Gas and Gas Liquids

Operations showed a pretax loss of $8 million, compared with pretax earnings of $291 million in 1985 and $344 million in 1984. The $299 million decrease in 1986 was due primarily to lower sales prices and volumes, partly offset by lower natural gas purchase costs.

Petroleum Refining, Marketing and Transportation

Pretax earnings for 1986 increased 34 percent to $458 million, compared with $342 million in 1985 and $203 million in 1984. The improvement was due primarily to lower feedstock and operating costs, partly offset by lower sales prices, primarily for gasoline and distillates.

Chemicals

Pretax earnings for 1986 increased to $299 million, compared with $219 million in 1985 and $221 million in 1984. Earnings benefited from lower feedstock costs and improved operating efficiencies. Partly offsetting these increases were lower sales prices, primarily for olefins and polyethylene.

Corporate and Other

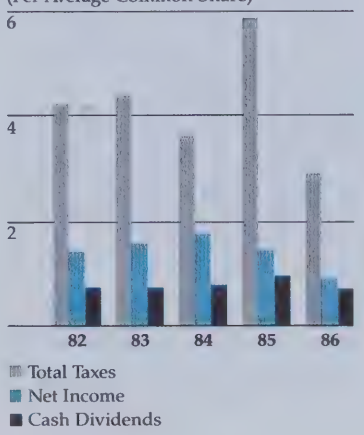
Corporate and Other, consisting primarily of interest expense, interest income and unusual items, reflected a pretax loss of $312 million in 1986, compared with pretax losses of $778 and $447 million in 1985 and 1984, respectively. The improvement in 1986 of $466 million was due primarily to the gain from restructuring the company's primary retirement plan and lower interest expense. The improvement was partly offset by higher expenses for the special separation programs.

Provision for Income Taxes

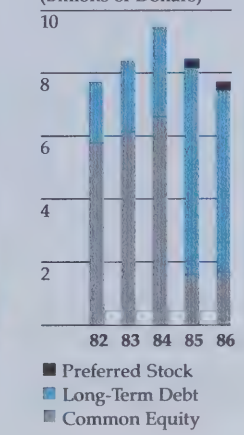
The provision for income taxes for continuing operations was $458 million in 1986, compared with $1.4 and $1.3 billion in 1985 and 1984, respectively. Lower financial income due to the decline in crude oil prices was the primary reason for the lower income tax provision in 1986. The effective income tax rate, including discontinued operations, was 66 percent in 1986, compared with 74 percent in 1985 and 61 percent in 1984.

FASB in 1986 issued an exposure draft on accounting for income taxes that would significantly change the rules under which deferred income taxes are computed. Assuming the new rules are adopted as described in the exposure draft and Phillips implements them in 1987, it is expected that they will have a

Total Taxes, Net Income and Cash Dividends
(Per Average Common Share)



Capitalization
(Billions of Dollars)



significant favorable impact on 1987 earnings. This impact will result from adjusting existing deferred income taxes, partly offset by recording tax on the company's equity in undistributed earnings of certain companies and corporate joint ventures.

CAPITAL RESOURCES AND LIQUIDITY

The company's current ratio, the ratio of current assets to current liabilities, was 1.3 at year-end 1986, compared with 1.0 and .9 for 1985 and 1984, respectively. The improvement in the current ratio for 1986 was primarily due to an increase in cash and short-term investment balances of $465 million, which resulted from operations, the company's asset sales program and the retirement plan restructuring, partly offset by long-term debt payments. Accrued taxes were significantly reduced during 1986, in part because the company settled certain pending claims.

The company's short-term liquidity position is stronger than the current ratio indicates because inventories are valued using the last-in, first-out (LIFO) method, which values inventories at lower historical costs.

During 1986, as in 1985, the company continued its emphasis on repaying debt obligations having relatively near-term maturities. Total indebtedness was reduced $839 million. This included a long-term debt reduction of $790 million to $5.8 billion. The long-term debt reduction was composed of $618 million of prepayments and open market purchases, $182 million now classified as current and an offsetting $10 million drawdown under an existing credit facility. Compared with year-end 1985, the current portion of long-term debt decreased $25 million, reflecting $207 million of scheduled debt payments.

During 1986, the company and Phillips Petroleum Credit Corporation (Credit) canceled the remaining $300 million of their $1 billion Revolving Credit Facility which would have otherwise terminated in April 1988. The company and Credit also chose not to renew $152 million of individual lines of credit in 1986.

As discussed in Note 10 to the financial statements relative to the retirement plan restructuring, the company has agreed to certain restrictive covenants in a letter of credit agreement. One of these covenants requires that the company maintain minimum cash balances of $750 million. The letter of credit provided under the agreement indemnifies an insurance company for payment of additional benefits to plan participants that would be required should a change in control of the company occur prior to January 1, 1988. At the company's option, the letter of credit may be prefunded and the letter of credit agreement canceled.

In addition to debt reduction, several other actions were taken during 1986 to increase the company's financial flexibility: the work force was reduced by 3,500 employees—2,600 of whom accepted a special separation program—to a year-end level of 21,800; on April 29, 1986, the company reduced its quarterly common stock dividend from 25 to 15 cents per share; and capital expenditures were reduced significantly from prior year levels.

Amidst an uncertain oil and gas pricing environment, the company has chosen to maintain cash balances in excess of its day-to-day operating needs. These cash balances, along with cash flow from operations, are anticipated to meet the company's expected liquidity requirements.

During 1986, the company announced that it may repurchase up to six million shares of its outstanding redeemable preferred stock prior to December 31, 1987. Through year-end 1986, 619,739 shares had been repurchased.

Phillips worldwide operations are capital intensive, requiring significant expenditures over long construction periods. Capital expenditures for properties, plants and equipment totaled $655 million in 1986, compared with $1.1 billion in 1985 and $1.4 billion in 1984. Over the past three years, significant expenditures have been made for developing the Point Arguello field in the Santa Maria Basin offshore California and the waterflood project in the Norwegian North Sea; for developing existing domestic properties and connecting new gas to existing facilities; for modernizing and improving the feedstock flexibility of Phillips major refineries; and for modernizing Phillips retail gasoline outlets. During this period, almost 80 percent of the company's capital expenditures were made in the United States. Over the three-year period, capital expenditures for Petroleum Exploration and Production operations accounted for 58 percent of the total; Gas and Gas Liquids operations—18 percent; Petroleum Refining, Marketing and Transportation operations—9 percent; Chemicals operations—5 percent; and Corporate and Other—10 percent.

In addition to capital expenditures, Phillips has charged against income a total of $1.5 billion over the past three years as a result of its worldwide exploration for petroleum reserves. A comparison of the components of exploration expense is shown below.

	Millions of Dollars		
	1986	1985	1984
Geological and geophysical	**$134**	208	269
Leasehold impairment	**191**	142	182
Dry hole	**120**	83	109
Lease rentals	**12**	16	13
	$457	449	573

The company's crude oil reserves declined 20 percent for the year, but reserves of natural gas and natural gas liquids increased 5 and 14 percent, respectively. The asset disposition program, which began in 1985, lowered proved hydrocarbon reserves approximately 12 percent over the two-year period. The increase in natural gas reserves was primarily due to reducing the gas-reinjection program in the Ekofisk field. These reserves had been revised downward in 1985 when the reinjection program was initiated.

The company's major net income exposures to foreign currency movements are due to its foreign deferred tax liabilities. Changes in the value of the dollar against certain foreign currencies can result in sizable fluctuations in net income because FASB Statement No. 52, "Foreign Currency Translation," requires foreign deferred taxes to be valued at current exchange rates. The company does not hedge these exposures because gains and losses on foreign deferred taxes do not impact cash flow. The company hedges, where feasible and appropriate, foreign exchange exposures which impact cash flow.

The Tax Reform Act of 1986 is expected to have minimal impact on the company's liquidity position for the years 1987 through 1989, assuming that oil prices remain in the mid-teens. In later years, the tax savings attributable to lower tax rates are expected to be more than offset by the repeal of the investment tax credit and changes in depreciation and intangible drilling cost rules. The impact on income from continuing operations is not expected to be material.

CHANGING PRICES AND THE EFFECT OF INFLATION

Market conditions continue to be the primary factor in determining the prices and costs of company products. Inflation did not have a significant effect on other aspects of the company's operations during 1986.

OUTLOOK

Looking forward to 1987, the major uncertainty is the price of oil and gas. An environment of fluctuating oil and gas prices requires constant reassessment of spending plans on long-term projects. Phillips expects that capital expenditures for 1987 will be between $700 and $800 million. The major portion of capital expenditures will be devoted to projects for Petroleum Exploration and Production, primarily for development of offshore California and Gulf of Mexico properties, the Ekofisk field waterflood program and the Audrey field in the U.K. North Sea. Expenditures for Gas and Gas Liquids will be devoted primarily to connecting gas to existing plants in active drilling areas and maintaining processing plants. Downstream capital expenditures will include modifying refineries to meet the EPA lead phase-down rule and allow higher octane motor fuel production which will support Phillips expanding motor fuel sales program; completing the polypropylene plastic resin facilities expansion at the Houston, Texas, chemical complex; and expanding polypropylene nonwoven fabric production lines.

Due to sales of assets, the natural decline that occurs in maturing fields and temporary reductions mandated by foreign governmental authorities, the company expects crude oil production to be approximately 10 percent lower in 1987, compared with 1986.

The company's financing alternatives continue to be affected by the current level of long-term debt and attendant interest expense, continuing uncertainty in oil and gas prices, and the loss of investment-grade ratings for the company's bonds. Over the next three years, Phillips hopes to reduce its debt to between $4.5 and $5.0 billion. To meet its liquidity requirements and reduce existing debt balances, the company will look primarily to funds from operations and existing cash balances.

Common Stock Prices and Cash Dividends Per Share

	1986			1985*		
	Stock Price		Dividends	Stock Price		Dividends
Quarter	High	Low		High	Low	
First	$12⅝	9⅛	.25	17⅛	12¼	.20
Second	11⅛	9¼	.15	13⁷/₁₂	11¼	.25
Third	11⅞	8¼	.15	13¼	11¼	.25
Fourth	12⅛	9¼	.15	13½	11	.25

Closing Stock Price at December 31, 1986	$11¾
Number of Stockholders of Record at January 31, 1987	108,123

**Adjusted for three-for-one stock split in the form of a 200-percent common stock dividend effective May 31, 1985.*

Phillips common stock is traded on the New York, Pacific and Toronto stock exchanges.

Selected Financial Data

	Millions of Dollars Except Per Share Amounts				
	1986	1985	1984	1983	1982
Sales and other operating revenues	$ 9,786	15,636	15,527	15,248	15,697
Income from continuing operations	234	596	837	760	701
Income from continuing operations per common share*	.91	2.07	1.81	1.65	1.53
Total assets	12,399	14,045	16,955	13,088	12,073
Long-term debt	5,757	6,547	2,839	2,242	1,955
Redeemable preferred stock	270	281	—	—	—
Cash dividends declared					
Per common share*	.70	.95	.78	.73	.73
Per preferred share	2.02	1.04	—	—	—

**Adjusted for three-for-one stock split in the form of a 200-percent common stock dividend effective May 31, 1985.*

See Management's Discussion and Analysis for discussion of factors that would enhance an understanding of these financial data.

Report of Certified Public Accountants

The Board of Directors and Stockholders
Phillips Petroleum Company

We have examined the accompanying consolidated balance sheet of Phillips Petroleum Company at December 31, 1986 and 1985, and the related consolidated statements of income, changes in common stockholders' equity and changes in financial position for each of the three years in the period ended December 31, 1986. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above present fairly the consolidated financial position of Phillips Petroleum Company at December 31, 1986 and 1985, and the consolidated results of operations and changes in financial position for each of the three years in the period ended December 31, 1986, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

Arthur Young & Company

Tulsa, Oklahoma
February 17, 1987

Consolidated Statement of Income

PHILLIPS PETROLEUM COMPANY

Years Ended December 31	Millions of Dollars		
	1986	1985	1984
Revenues			
Sales and other operating revenues	**$ 9,786**	15,636	15,527
Equity in earnings of affiliated companies	**64**	37	42
Other revenues	**165**	127	177
Total Revenues	**10,015**	15,800	15,746
Costs and Expenses			
Purchased crude oil and products	**5,313**	9,041	9,057
Production and operating expenses	**1,626**	1,829	1,898
Exploration expenses	**457**	449	573
Selling, general and administrative expenses	**308**	412	476
Depreciation, depletion, amortization and retirements	**1,097**	1,044	905
Taxes other than income taxes	**210**	406	405
Interest and expense on indebtedness	**685**	846	314
Unusual items	**(373)**	(180)	—
Total Costs and Expenses	**9,323**	13,847	13,628
Income from continuing operations before income taxes	**692**	1,953	2,118
Provision for income taxes	**458**	1,357	1,281
Income from Continuing Operations	**234**	596	837
Discontinued operations (net of income taxes)			
Loss from operations	**—**	(7)	(27)
Loss on disposal	**(6)**	(171)	—
Net Income	**$ 228**	418	810
Net Income Applicable to Common Stock	**$ 202**	401	810
Income Per Share of Common Stock			
Continuing operations	**$ .91**	2.07*	1.81*
Net income	**$ .89**	1.44*	1.75*
Average Common Shares Outstanding (in thousands)	**227,546**	278,916*	462,247*

**Adjusted for three-for-one stock split in the form of a 200-percent common stock dividend effective May 31, 1985.*
See accounting policies and notes to financial statements.

Consolidated Balance Sheet

PHILLIPS PETROLEUM COMPANY

At December 31	Millions of Dollars	
	1986	1985
Assets		
Current Assets		
Cash and Short-Term Investments	**$ 1,141**	676
Accounts and Notes Receivable (less allowances: 1986—$10; 1985—$16)	**1,046**	1,645
Inventories	**507**	642
Prepaid Expenses and Other Current Assets	**106**	181
Total Current Assets	**2,800**	3,144
Investments and Long-Term Receivables	**316**	375
Properties, Plants and Equipment (net)	**9,139**	10,281
Deferred Charges	**20**	83
Net Assets of Discontinued Operations	**124**	162
Total	**$12,399**	14,045
Liabilities		
Current Liabilities		
Accounts Payable	**$ 917**	1,331
Notes Payable	**6**	30
Long-Term Debt due within one year	**182**	207
Accrued Income and Other Taxes	**899**	1,261
Other Accruals	**227**	281
Total Current Liabilities	**2,231**	3,110
Long-Term Debt	**5,757**	6,547
Other Long-Term Liabilities	**363**	533
Accrued Contingent Liabilities	**201**	151
Deferred Income Taxes	**1,685**	1,673
Other Deferred Credits	**144**	70
Minority Interest in Consolidated Subsidiaries	**24**	36
Total Liabilities	**10,405**	12,120
Redeemable Preferred Stock		
Series A Adjustable Rate ($1.00 par value) Shares Issued and Outstanding (1986—11,341,460; 1985—11,961,199) (mandatory redemption value: 1986—$284; 1985—$299)	**270**	281
Common Stockholders' Equity		
Common Stock—500,000,000 shares authorized at $1.25 par value Issued (248,684,301 shares)		
Par Value	**311**	311
Capital in Excess of Par	**224**	213
Treasury Stock (at cost: 1986—20,351,602 shares; 1985—21,543,631 shares)	**(1,241)**	(1,313)
Foreign Currency Translation Adjustments	**(49)**	(74)
Earnings Employed in the Business	**2,479**	2,507
Total Common Stockholders' Equity	**1,724**	1,644
Total	**$12,399**	14,045

See accounting policies and notes to financial statements.

Consolidated Statement of Changes in Financial Position

Years Ended December 31	Millions of Dollars		
	1986	1985	1984
Funds from Continuing Operations			
Income from continuing operations	**$ 234**	596	837
Items not affecting working capital:			
Depreciation, depletion, amortization and retirements	**1,097**	1,044	905
Dry hole costs and leasehold impairment	**311**	225	291
Deferred taxes	**(222)**	358	223
Other	**(157)**	(94)	(23)
Funds from continuing operations, excluding working capital changes	**1,263**	2,129	2,233
Working capital changes, excluding changes in cash, short-term investments and debt:			
Accounts and notes receivable	**599**	33	(462)
Inventories	**135**	229	(206)
Prepaid expenses and other current assets	**75**	(22)	(51)
Accounts payable	**(414)**	(345)	391
Taxes and other accruals	**(416)**	(155)	246
	1,242	1,869	2,151
Investment Activities			
Capital expenditures, including dry hole costs	**(655)**	(1,060)	(1,368)
Purchase of net noncurrent assets of acquired companies	**—**	—	(1,784)
Property sales and retirements	**537**	800	56
Pension plan reversion	**203**	—	—
Investment purchases	**(23)**	—	(13)
Investment sales	**180**	7	41
Other (net)	**(55)**	141	(12)
Funds provided from (used for) investment activities	**187**	(112)	(3,080)
Financing Activities			
Increase (decrease) in notes payable	**(24)**	(1,860)	1,779
Increase (decrease) in long-term debt due within one year	**(25)**	125	52
Additional long-term debt	**11**	5,576	1,032
Reduction of long-term debt	**(776)**	(1,864)	(406)
Purchase of company stock	**(15)**	(4,972)	—
Issuance of company stock	**13**	372	55
Dividends to company stockholders	**(183)**	(554)	(362)
Funds provided from (used for) financing activities	**(999)**	(3,177)	2,150
Discontinued Operations	**35**	202	(233)
Increase (Decrease) in Cash and Short-Term Investments	**$ 465**	(1,218)	988

See accounting policies and notes to financial statements.

Consolidated Statement of Changes in Common Stockholders' Equity

Millions of Dollars

	Shares of Common Stock			Common Stock				
	Issued	Held in Treasury	Outstanding	Par Value	Capital in Excess of Par	Treasury Stock	Foreign Currency Translation Adjustments	Earnings Employed in the Business
December 31, 1983	154,449,429	1,226,265	153,223,164	$193	490	(62)	(81)	5,609
Net income								810
Cash dividends declared and paid								(362)
Issued in exchange for debt	502,552	(900,000)	1,402,552	1	9	46		
Issued under incentive compensation plans		(990)	990					
Current period translation adjustment							(29)	
December 31, 1984	154,951,981	325,275	154,626,706	194	499	(16)	(110)	6,057
Net income								418
Cash dividends declared and paid								
Common								(261)
Preferred								(12)
Common stock dividend	93,732,320	(53,000,000)	146,732,320	117	(353)	3,232		(2,996)
Preferred stock dividend								(281)
Sold to employee benefit plans		(7,240,100)	7,240,100		67	442		(416)
Exchange offer		72,580,000	(72,580,000)			(4,500)		
Stock purchases		8,898,800	(8,898,800)			(472)		
Issued under incentive compensation plans		(20,344)	20,344			1		
Current period translation adjustment							51	
Translation adjustment recognized upon disposal of foreign investments							(15)	
Accretion of discount on preferred stock								(2)
December 31, 1985	248,684,301	21,543,631	227,140,670	311	213	(1,313)	(74)	2,507
Net income								228
Cash dividends declared and paid								
Common								(159)
Preferred								(24)
Issued under incentive compensation plans		(1,192,029)	1,192,029		11	72		(70)
Current period translation adjustment							15	
Translation adjustment recognized upon disposal of foreign investments							10	
Accretion of discount on preferred stock								(3)
December 31, 1986	**248,684,301**	**20,351,602**	**228,332,699**	**$311**	**224**	**(1,241)**	**(49)**	**2,479**

See accounting policies and notes to financial statements.

Consolidation Principles and Investments—The consolidated financial statements include the accounts of companies owned more than 50 percent except for an insurance company and a credit company. Investments in these two companies, in companies owned 20–50 percent, inclusively, and in corporate joint ventures are accounted for using the equity method of accounting (affiliated companies). Investments in other companies are carried at cost.

Inventories—Crude oil, petroleum products, chemicals and merchandise are valued at cost, which is lower than market in the aggregate, mainly on the last-in, first-out (LIFO) basis. Materials and supplies are valued at or below average cost.

Oil and Gas Exploration and Development—Oil and gas exploration and development costs are accounted for using the successful efforts method of accounting.

Property Acquisition Costs—Oil and gas leasehold acquisition costs are capitalized. Leasehold impairment is recognized based upon unsuccessful exploratory experience. Upon discovery of commercial reserves, leasehold costs are transferred to producing properties.

Exploratory Costs—Geological and geophysical expenses and the costs of carrying and retaining undeveloped properties are charged against income as incurred. Exploratory drilling costs are capitalized when incurred. If exploratory wells are determined to be commercially unsuccessful or dry holes, applicable costs are expensed.

Development Costs—Costs incurred to drill and equip development wells, including unsuccessful development wells, are capitalized.

Depletion and Amortization—Leasehold costs of producing properties are depleted using the unit-of-production method based on estimated proved oil and gas reserves. Amortization of intangible development costs is based on the unit-of-production method using the estimated proved developed oil and gas reserves.

Depreciation and Amortization—Depreciation and amortization of properties, plants and equipment, including assets under capital leases, are determined by the group straight-line method, individual unit straight-line method or the unit-of-production method, applying the method considered most appropriate for each type of property.

Property Dispositions—When complete units of depreciable property are retired or sold, the asset cost and related accumulated depreciation are eliminated with any gain or loss reflected in income. When less than complete units of depreciable property are disposed of or retired, the difference between asset cost and salvage value is charged or credited to accumulated depreciation.

Dismantlement, Removal and Restoration Costs—The estimated costs, net of salvage values, of dismantling and removing major facilities, including necessary site restoration, are accrued currently. Accrual methods used are unit-of-production or straight-line, applying the method considered most appropriate for each type of property.

Foreign Currency Translation—The U.S. dollar is the functional currency for most of the company's operations. Adjustments resulting from the process of translating foreign functional currency financial statements into U.S. dollars are taken directly to a separate component of common stockholders' equity. Foreign currency transaction gains and losses are included in income.

Income Taxes—Deferred taxes are provided for all significant timing differences in the recognition of revenues and expenses for tax and financial purposes. Allowable tax credits are applied currently as reductions of the provision for income taxes. No provision for U.S. income taxes is made on undistributed earnings of certain companies and corporate joint ventures because of reinvestment plans for such funds.

Income Per Share of Common Stock—Income per share of common stock is determined after deducting the dividend requirements of preferred stock and the accretion of the excess of redemption value of preferred stock over its carrying value. The calculation is based upon the daily weighted average number of common shares outstanding during the period.

Note 1—Discontinued Operations and Unusual Items

During 1985, the company announced plans to discontinue its minerals operations. Assets associated with these operations were sold, abandoned, or written down to estimated net realizable value in anticipation of their future sale or abandonment, resulting in an estimated net loss on disposal in 1985 of $171 million, net of income tax benefits of $132 million. This loss included $21 million before-tax for estimated operating losses during the phase-out period. During 1986, minor adjustments were made to the estimated 1985 loss on disposal. The Notes to Financial Statements, where applicable, exclude discontinued operations.

Unusual items consisted of the following for the years ended December 31:

	Millions of Dollars	
	1986	1985
Special separation programs	**$(114)**	(21)
Retirement plan restructuring	**275**	—
Asset disposition program	**212**	201
	$ 373	180

Combined, the above-named unusual items increased net income $232 and $136 million in 1986 and 1985, respectively.

Note 2—Inventories

Inventories at December 31 consisted of the following:

	Millions of Dollars	
	1986	1985
Crude oil, petroleum products and chemicals	**$375**	472
Merchandise	**12**	22
	387	494
Materials and supplies	**120**	148
	$507	642

Inventories valued on a LIFO basis totaled $325 and $393 million at December 31, 1986 and 1985, respectively, and would have been approximately $292 and $665 million higher, respectively, had they been valued using the first-in, first-out (FIFO) method. The FIFO values were determined using costs and allocations consistent with those used to determine LIFO inventories.

Note 3—Investments and Long-Term Receivables

Components of investments and long-term receivables at December 31 were as follows:

	Millions of Dollars	
	1986	1985
Investments in and advances to affiliated companies		
Phillips Petroleum Credit Corporation	**$ —**	119
Walton Insurance Limited	**20**	15
Companies owned 50 percent or less	**150**	161
Long-term receivables	**121**	61
Other investments	**25**	19
	$316	375

Earnings employed in the business at December 31, 1986, included $105 million relating to undistributed earnings of affiliated companies. Dividends received from affiliated companies were $184, $41 and $41 million in 1986, 1985 and 1984, respectively.

Phillips Petroleum Credit Corporation (Credit) purchases certain accounts receivable from Phillips with funds obtained from short-term borrowings. During 1985 and 1984, Phillips received $1.8 and $4.7 billion, respectively, in proceeds from the sale of accounts receivable to Credit. No accounts receivable were sold to Credit during 1986. At December 31, 1985, Credit held accounts receivable acquired from Phillips of $121 million.

Walton Insurance Limited (Walton) participated in the international reinsurance business, including insuring certain Phillips risks, until January 27, 1983, when Walton ceased writing new third-party reinsurance.

Note 4—Properties, Plants and Equipment

The company's investment in properties, plants and equipment (at cost) at December 31 is summarized as follows:

	Millions of Dollars	
	1986	1985
Exploration and Production	**$ 8,798**	9,395
Gas and Gas Liquids	**2,022**	2,093
Petroleum Products	**2,881**	2,870
Chemicals	**1,332**	1,533
Corporate and Other	**792**	798
	15,825	16,689
Accumulated depreciation, depletion and amortization	**6,686**	6,408
	$ 9,139	10,281
Assets under capital leases included above	**$ 29**	34
Accumulated amortization	**23**	23
	$ 6	11

Note 5—Debt

Long-Term

Long-term debt due after one year at December 31 consisted of the following:

	Millions of Dollars	
	1986	1985
Floating Rate Senior Notes Due 1995*	**$1,661**	1,973
14¾% Subordinated Debentures Due 2000	**1,089**	1,089
14% Guaranteed Notes Due 1989	**—**	200
13⅞% Senior Notes Due 1997	**1,299**	1,306
12⅞% Notes Due September 1, 1992	**187**	200
12¼% Debentures Due 2012	**297**	300
11¼% Debentures Due 2013	**250**	250
8⅞% Debentures Due 2000	**149**	175
7⅝% Debentures Due 2001	**96**	109
5⅝% Marine Terminal Revenue Bonds, Series 1977 Due 2007	**20**	20
Notes payable to banks, insurance companies and others due through 1993		
At 9%–15½%	**90**	310
At 8%–8 15/16%	**176**	207
At 7%–7¾%	**179**	14
Production payment	**253**	376
Obligations under capital leases	**6**	12
Purchase obligations	**5**	6
	$5,757	6,547

**Interest rates at December 31, 1986 and 1985, were 7 1/16 and 9 9/16 percent, respectively.*

Maturities of long-term debt in 1987 through 1991 are: $182 (included in current liabilities), $178, $111, $87 and $117 million, respectively.

Compensating Balances

The company maintains compensating balances for banking services under various arrangements with several banks. The compensating balances are not legally restricted as to withdrawal and are continually reviewed and adjusted based on levels of services and activity. The total of all compensating balances is not material in relation to total liquid assets.

Note 6—Other Long-Term Liabilities

Other long-term liabilities at December 31 consisted of the following:

	Millions of Dollars	
	1986	1985
Dismantlement, removal and restoration costs		
United States	**$160**	134
Outside United States	**109**	327
Other	**94**	72
	$363	533

In 1986, the Norwegian government adopted a law implementing a grant system, under which the Norwegian government will reimburse the company for a portion of the actual dismantlement costs. The effect on net income was not material.

Note 7—Non-Mineral Leases

The company leases bulk and service stations, computers and other facilities and equipment under both capital and operating leases.

At December 31, 1986, future minimum payments due under noncancelable leases were as follows:

	Millions of Dollars	
	Capital Leases	Operating Leases
1987	$ 4	41
1988	2	30
1989	2	22
1990	2	14
1991	1	10
Remaining years	1	79
Total payments*	12	196
Less imputed interest	3	
Present value	9	
Amount included in current liabilities	3	
Obligations under capital leases	$ 6	

**Minimum payments have not been reduced by aggregate minimum sublease rentals due under noncancelable subleases of $2 million for capital leases and $4 million for operating leases.*

Operating lease rental expense for the years ended December 31 was as follows:

	Millions of Dollars		
	1986	1985	1984
Total rentals	**$93**	110	92
Less sublease rentals	**9**	9	8
Net rentals	**$84**	101	84

Note 8—Redeemable Preferred Stock

Each Series A preferred share has a liquidation value of $25 and is redeemable at the option of the company at prices declining $.25 per share annually from $25.50 on May 15, 1986, until the mandatory redemption value of $25 per share is reached, with required redemption on May 15, 1990. The dividend rate is adjusted quarterly based on certain applicable U.S. Treasury rates. The dividend rate was 6.6 and 9.0 percent at December 31, 1986 and 1985, respectively. The preferred stockholders do not have voting rights unless dividends payable become six quarters in arrears, at which time the holders of the preferred, voting as a class, have the right to elect two directors. No dividends may be paid on common stock unless full cumulative dividends on the preferred stock have been declared and paid. The preferred stock was recorded at fair market value at issuance. The excess of the redemption value over the carrying value is accreted (added to book value) over the life of the issue.

Note 9—Preferred Share Purchase Rights

On July 10, 1986, the company distributed a dividend of one Preferred Share Purchase Right (Right) for each outstanding share of common stock.

The Rights are not exercisable or transferable, apart from the company's common stock, until after a person or group acquires, or has the right to acquire, beneficial ownership of 20 percent or more of the company's common stock or announces a tender or exchange offer for 30 percent or more of the company's common stock.

Each Right entitles the holder to purchase one one-hundredth of a share of a new series of preferred stock for $35. The Rights contain anti-dilution provisions under which, in the event the company were acquired, or 50 percent or more of its consolidated assets or earning power were sold, and the Rights were not redeemed, each Right would entitle the holder to receive at the then current exercise price that number of common shares of the acquiring company equivalent to two times the exercise price of each Right on the transaction date. If a 20-percent or more stockholder were to acquire the company by means of a reverse merger, or engage in certain selfdealing transactions with the company, each Right not owned by such stockholder would entitle the holder to buy that number of shares of the company's common stock equivalent to two times the then current exercise price.

The redemption price of the Rights is 8⅓ cents per Right. The Rights will expire, unless previously redeemed or exercised, on July 10, 1993. At December 31, 1986, there were 228,332,699 Rights outstanding.

Note 10—Other Contingent Liabilities

In addition to the accrued contingent liabilities shown on the balance sheet, the company has other contingent liabilities for which no provision has been made.

A number of legal proceedings are pending in various courts or agencies in which the company or a subsidiary appears as plaintiff or defendant. In January 1987, the company received a Proposed Remedial Order from the Economic Regulatory Administration of the Department of Energy (DOE) alleging certain violations of the DOE price control regulations relating to crude oil purchases and sales in 1979 and 1980. The company believes that the transactions at issue are authorized under the terms of a Consent Order which it entered into with the DOE early in 1980, as well as being permitted under DOE regulations. The company intends to contest this matter vigorously. An estimate of loss, if any, cannot be made at this time.

At December 31, 1986 and 1985, the company was contingently liable for $22 and $21 million, respectively, for obligations of affiliated companies and others. In addition, the company had contingent liabilities at both dates resulting from throughput agreements with pipeline and processing companies in which it holds stock interests. Under these agreements, Phillips may be required to provide any such company with additional funds through advances against future charges for the shipping or processing of petroleum liquids, natural gas and refined products.

In connection with the retirement plan restructuring as discussed in Note 12, the company has agreed to indemnify the insurance company for payment of additional benefits to plan participants that would be required should a change in control of the company occur prior to January 1, 1988. The indemnification liability, estimated at $375 million, terminates December 31, 1987, if the insurance company has not become obligated to make additional benefit payments. As part of the indemnification agreement, the company named the insurance company beneficiary of a $200 million letter of credit which expires on January 5, 1988, unless earlier drawn. In the letter of credit agreement, the company agreed to certain restrictive covenants including maintenance of a minimum cash balance and restrictions on total indebtedness and sales or transfers of assets. At the option of the company, the letter of credit may be prefunded and the letter of credit agreement canceled.

While it is not possible at this time to establish the ultimate amount of liability with respect to these contingent liabilities, including those related to legal proceedings, the company is of the opinion that the aggregate amount of any such liabilities for which provision has not been made will not have a material adverse effect on its financial position.

Note 11—Incentive Compensation Plans

The company has two incentive compensation plans that provide awards to key employees. These plans are the Incentive Compensation Plan and the 1986 Stock Plan, which replaced the Long-Term Incentive Compensation Plan effective January 1, 1986. In anticipation of awards that may become payable under the plans, provisions of $10, $14 and $11 million have been charged against earnings in 1986, 1985 and 1984, respectively.

The 1986 Stock Plan, which includes the Stock Option Plan and the Strategic Incentive Plan, is in effect for the five-year period beginning January 1, 1986, through December 31, 1990. The maximum number of shares of the company's common stock that may be used to satisfy the 1986 Stock Plan's obligations for the five-year period, subject to stock splits, stock dividends and other similar actions, cannot exceed 3.5 percent of such shares outstanding as of December 31, 1985 (approximately 8 million shares).

Note 12—Retirement Income Plans

The company elected to adopt FASB Statement No. 87, "Employers' Accounting for Pensions," with respect to its U.S. retirement plans, effective January 1, 1985. Application of FASB Statement No. 87 increased 1985 earnings $57 million before-tax, $31 million after-tax ($.11 per common share).

The company has defined benefit retirement plans covering substantially all employees. Effective September 1, 1986, the company's principal retirement plan was restructured into two separate plans—one covering active employees and the other covering retirees. Annuity contracts, purchased from an insurance company, settled the company's obligation for retiree benefits as well as those accrued by active employees as of September 1, 1986. On that date, a surplus of $125 million of assets remained in the active plan. Surplus funds of $379 million were returned to the company.

The active plan is noncontributory and benefits for service on or after September 1, 1986, are based on an employee's years of service and average earnings for the three highest consecutive calendar years of compensation during the 10 years immediately preceding retirement. Plans of subsidiaries which have not adopted the company's principal retirement plan are generally noncontributory with benefit formulas based on employee earnings, credited service or both. The company's funding policy for U.S. plans is to contribute the minimum required by the Employee Retirement Income Security Act of 1974. Plans for the majority of foreign employees are fully insured, and premiums are expensed when paid. Pension cost (income) was as follows:

	Millions of Dollars		
	1986	1985	1984
U.S. Plans			
Service cost—benefits earned during the period	**$ 23**	28	38
Interest cost on projected benefit obligation	**64**	101	—
Return on assets			
Actual	**(158)**	(300)	—
Deferred gains	**64**	149	—
Amortization of			
Net asset	**(18)**	(31)	—
Unrecognized net gains	**(7)**	—	(37)
Net pension cost (income) for U.S. plans	**(32)**	(53)	1
Foreign Plans	**8**	8	7
Net pension cost (income)	**$ (24)**	(45)	8

Assumptions Used for U.S. Plans—Weighted Average at December 31	**1986**	1985	1984
Discount rate	**9¼%**	9¼	8
Rate of increase in compensation levels	**6¼**	7	6
Long-term rate of return on assets	**9¼**	9¼	8

In determining net pension cost, the company has elected to amortize, on a straight-line basis over 10 years, net gains and losses arising subsequent to its adoption of FASB Statement No. 87 effective January 1, 1985. The restructuring of the company's principal retirement plan in 1986 increased pension cost $22 million.

All the company's funded U.S. plans have assets in excess of the accumulated benefit obligation. Assets include commingled funds, a participation right to an annuity contract, deposit administration insurance contracts and real estate. The following table presents the funded status of the plans and a reconciliation with (accrued) prepaid pension cost and deferred gain on reversion at December 31.

	Millions of Dollars	
	1986	1985
Plan assets at fair value	**$ 158**	1,454
Actuarial present value of benefit obligations		
Vested benefits	**47**	688
Nonvested benefits	**1**	39
Accumulated benefit obligation	**48**	727
Effect of projected future salary increases	**105**	219
Projected benefit obligation	**153**	946
Plan assets in excess of projected benefit obligation	**5**	508
Unrecognized net gains	**(12)**	(96)
Unrecognized net asset	**(96)**	(353)
(Accrued) prepaid pension cost and deferred gain on reversion	**$ (103)**	59

The restructuring at September 1, 1986, reduced the plan assets $1,316 million, the projected benefit obligation $937 million, the unrecognized net gains $37 million, and the unrecognized net asset $238 million.

Note 13—Foreign Currency Gains and Losses

After-tax transaction gains and losses increased earnings $87 and $42 million in 1986 and 1984, respectively, and decreased earnings $9 million in 1985.

Note 14—Taxes

Taxes charged to income were as follows:

	Millions of Dollars		
	1986	1985	1984
Taxes Other Than Income Taxes			
Property	**$ 78**	76	64
Crude oil excise	**13**	127	137
Production	**57**	115	124
Payroll	**41**	55	52
Other	**21**	33	28
	210	406	405
Discontinued operations	**—**	6	1
	210	412	406
Income Taxes			
Federal			
Current	**196**	(8)	57
Deferred	**(165)**	193	192
Foreign			
Current	**429**	964	987
Deferred	**(19)**	189	28
State and local (current)	**17**	19	17
	458	1,357	1,281
Discontinued operations	**(12)**	(144)	(26)
	446	1,213	1,255
Total taxes charged to income	**$ 656**	1,625	1,661

Federal income taxes of $193 million were paid in 1985 related to the purchase of Aminoil Inc.

Deferred income taxes related to timing differences were:

	Millions of Dollars		
	1986	1985	1984
Depreciation	**$ 99**	387	311
Intangible drilling and certain other costs	**(47)**	114	(14)
Dismantlement provision	**(16)**	(66)	(31)
Capitalized interest, net of amortization	**26**	20	(4)
Leasehold impairment	**(37)**	(22)	(9)
Contingencies	**(18)**	(20)	20
Unusual items			
Special separation programs	**(10)**	(9)	—
Retirement plan restructuring	**(61)**	—	—
Asset disposition program	**(86)**	(86)	—
Other	**(34)**	64	(53)
	(184)	382	220
Discontinued operations	**(9)**	(117)	4
	$ (193)	265	224

Deferred taxes have not been provided for the company's equity in undistributed earnings of certain companies and corporate joint ventures because of reinvestment plans for such funds. At December 31, 1986, 1985 and 1984, the aggregate of these funds was $311, $354 and $323 million, respectively, excluding amounts which if remitted would be expected to result in little or no tax because of available tax credits and other deductions.

The amounts of U.S. and outside U.S. income before income taxes and a reconciliation of tax at the federal statutory rate with the provision for income taxes follow:

	Millions of Dollars			Percent of Pretax Income		
	1986	1985	1984	**1986**	1985	1984
Continuing operations						
United States	**$ (60)**	609	817	**(8.9)%**	37.3	39.6
Outside United States	**752**	1,344	1,301	**111.6**	82.4	63.0
	692	1,953	2,118	**102.7**	119.7	102.6
Discontinued operations						
United States	**(18)**	(322)	(53)	**(2.7)**	(19.7)	(2.6)
	$674	1,631	2,065	**100.0%**	100.0	100.0
Continuing operations						
Federal statutory income tax	**$318**	898	974	**46.0%**	46.0	46.0
Foreign taxes in excess of federal statutory rate	**133**	544	380	**19.2**	27.9	17.9
Income taxed at capital gain rate	**(17)**	(90)	6	**(2.4)**	(4.6)	.3
Business tax credits	**(6)**	(26)	(33)	**(.9)**	(1.3)	(1.6)
Other	**30**	31	(46)	**4.3**	1.6	(2.2)
	$458	1,357	1,281	**66.2%**	69.6	60.4
Discontinued operations	**$ (12)**	(144)	(26)	**66.7%**	44.7	49.1
Total income taxes	**$446**	1,213	1,255	**66.2%**	74.4	60.8

Excise taxes collected on the sale of petroleum products and paid to taxing agencies were $168, $166 and $147 million for the years ended December 31, 1986, 1985 and 1984, respectively.

All deficiencies related to the examination of the company's U.S. income tax returns by the Internal Revenue Service have been settled through 1974. The company is of the opinion that any unsettled deficiencies for subsequent years will not have a material effect on the financial position of the company.

As a result of the Tax Reform Act of 1986, net income for 1986 decreased $19 million, primarily due to the repeal of the investment tax credit.

Note 15—Other Financial Information

	Millions of Dollars Except Per Share Amounts		
	1986	1985	1984
Interest			
Incurred	**$741**	897	360
Capitalized	**(56)**	(51)	(46)
Expensed	**$685**	846	314
Maintenance and repairs—expensed	**$339**	387	383
Research and development expenditures—expensed	**$ 89**	107	124
Dividends declared and paid per share			
On common stock			
Cash	**$ .70**	.95*	.78*
Preferred stock	**—**	1.36*	—
On preferred stock—cash	**2.02**	1.04	—

**Adjusted for three-for-one stock split in the form of a 200-percent common stock dividend effective May 31, 1985.*

Note 16—Segment and Geographic Information

The company is involved primarily in Petroleum and Chemicals operations. Petroleum operations are fully integrated and involve the exploration, production, processing, transportation and refining of crude oil and natural gas, together with the subsequent transportation and marketing of products derived therefrom. This segment also provides feedstock for the production of petrochemicals. Chemicals operations involve the manufacture and marketing of a broad range of petroleum-based chemical products. Miscellaneous operations are included in Other.

Sales and other operating revenues to outside customers and sales within Phillips by business segment and by geographic area are at market value. Operating profit excludes general corporate revenue and expense, interest, unusual items and income taxes. The company's share of earnings of affiliated companies has been included with the segment and geographic area in which the affiliate operates.

Intersegment and intergeographic sales are eliminated in determining consolidated revenue. Profit in inventory resulting from intercompany transfers has been eliminated from operating profit and the assets of the producing operation. Corporate assets are principally cash.

Analysis of Results by Business Segment

Years Ended December 31	Millions of Dollars		
	1986	1985	1984
Sales and Other Operating Revenues to Outside Customers			
Petroleum			
Exploration and production	**$ 1,284**	2,110	2,131
Gas and gas liquids	**811**	1,122	1,063
Refining, marketing and transportation	**5,955**	10,084	9,930
	8,050	13,316	13,124
Chemicals	**1,698**	2,266	2,351
Other	**38**	54	52
	$ 9,786	15,636	15,527
Sales within Phillips			
Petroleum			
Exploration and production	**$ 1,108**	2,131	2,075
Gas and gas liquids	**671**	1,115	1,205
Refining, marketing and transportation	**461**	638	681
Eliminations (intrasegment)	**(1,796)**	(3,262)	(3,297)
	444	622	664
Chemicals	**161**	241	304
Other	**26**	33	35
	$ 631	896	1,003
Summary of Income from Continuing Operations			
Operating Profit			
Petroleum			
Exploration and production	**$ 255**	1,879	1,797
Gas and gas liquids	**(8)**	291	344
Refining, marketing and transportation	**458**	342	203
	705	2,512	2,344
Chemicals	**299**	219	221
Other	**(17)**	(2)	(24)
Total operating profit	**987**	2,729	2,541
Other revenues	**151**	81	90
Nonoperating items	**(904)**	(2,214)	(1,794)
	$ 234	596	837
Total Assets			
Petroleum			
Exploration and production	**$ 5,601**	6,690	7,426
Gas and gas liquids	**1,289**	1,355	1,458
Refining, marketing and transportation	**2,500**	2,774	3,133
	9,390	10,819	12,017
Chemicals	**1,053**	1,315	1,498
Corporate and Other	**1,832**	1,749	2,775
Discontinued operations	**124**	162	665
	$12,399	14,045	16,955

Years Ended December 31	Millions of Dollars		
	1986	1985	1984
Depreciation, Depletion, Amortization and Retirements			
Petroleum			
Exploration and production	**$ 781**	716	585
Gas and gas liquids	**110**	101	88
Refining, marketing and transportation	**108**	105	100
	999	922	773
Chemicals	**66**	72	67
Corporate and Other	**32**	50	65
	$1,097	1,044	905
Capital Expenditures—Properties, Plants and Equipment			
Petroleum			
Exploration and production	**$ 349**	680	747
Gas and gas liquids	**89**	136	329
Refining, marketing and transportation	**75**	95	109
	513	911	1,185
Chemicals	**46**	45	77
Corporate and Other	**96**	104	106
	$ 655	1,060	1,368

Analysis of Results by Geographic Area

Years Ended December 31	Millions of Dollars		
	1986	1985	1984
Sales and Other Operating Revenues to Outside Customers			
United States	**$7,953**	12,511	12,457
Norway	**716**	1,100	1,067
Other Europe	**877**	1,700	1,650
Africa	**43**	141	92
Other areas	**197**	184	261
	$9,786	15,636	15,527
Sales within Phillips			
United States	**$ 102**	101	106
Norway	**109**	226	393
Other Europe	**11**	19	6
Africa	**161**	288	322
Other areas	**23**	23	35
	$ 406	657	862
Operating Profit			
United States	**$ 516**	1,390	1,302
Norway	**387**	950	919
Other Europe	**74**	182	181
Africa	**(38)**	195	182
Other areas	**48**	12	(43)
	$ 987	2,729	2,541

Years Ended December 31	Millions of Dollars		
	1986	1985	1984
Total Assets			
United States	**$ 8,320**	9,447	10,548
Norway	**1,071**	1,168	1,118
Other Europe	**511**	829	977
Africa	**239**	385	466
Other areas	**302**	305	406
Corporate and Other	**1,832**	1,749	2,775
Discontinued operations	**124**	162	665
	$12,399	14,045	16,955
Export Sales	**$ 415**	509	448

Selected Quarterly Financial Data

	Millions of Dollars			
	Sales and Other Operating Revenues	Income from Continuing Operations before Income Taxes	Net Income	Net Income Per Share of Common Stock*
1986				
First	**$3,070**	**326**	**96**	**.39**
Second	**2,301**	**53**	**8**	**.01**
Third	**2,117**	**240**	**113**	**.47**
Fourth	**2,298**	**73**	**11**	**.02**
1985				
First	3,922	445	113	.25
Second	3,939	408	117	.52
Third	3,905	437	93	.38
Fourth	3,870	663	95	.39

**Adjusted for three-for-one stock split in the form of a 200-percent common stock dividend effective May 31, 1985.*

Due to unusual items in 1986, income from continuing operations before income taxes has been increased by $138, $306 and $12 million in the first, third and fourth quarters, respectively, and decreased by $83 million in the second.

Unusual items in 1985 caused income from continuing operations before income taxes to be increased by $40 and $222 million in the first and fourth quarters, respectively, and decreased by $82 million in the third quarter.

During 1985, the company announced plans to discontinue its minerals operations as discussed in Note 1 to the financial statements. Net income includes losses from discontinued operations of $6 million in the fourth quarter of 1986, and $2, $1, $4 and $171 million for respective quarters in 1985.

Proved Reserves Worldwide

Years Ended December 31	Crude Oil — Millions of Barrels					
	United States	Norway	Other Europe	Other Africa	Other Areas	Total
Developed and Undeveloped						
End of 1983	406	251	43	107	28	835
Revisions of previous estimates	13	10	2	4	—	29
Improved recovery	4	—	—	—	—	4
Purchases of reserves in place	97	—	—	—	2	99
Extensions and discoveries	59	—	1	—	1	61
Production	(49)	(27)	(8)	(11)	(2)	(97)
End of 1984	530	234	38	100	29	931
Revisions of previous estimates	30	53	8	5	11	107
Improved recovery	5	—	—	—	—	5
Extensions and discoveries	6	—	1	—	3	10
Production	(56)	(23)	(9)	(11)	(2)	(101)
Sales of reserves in place	(49)	—	(2)	—	—	(51)
End of 1985	466	264	36	94	41	901
Revisions of previous estimates	(27)	(25)	—	(1)	(9)	(62)
Improved recovery	1	—	—	—	—	1
Purchases of reserves in place	1	—	—	—	—	1
Extensions and discoveries	6	—	86	1	1	94
Production	(44)	(19)	(8)	(11)	(2)	(84)
Sales of reserves in place	(48)	—	(85)	—	—	(133)
End of 1986	**355**	**220**	**29**	**83**	**31**	**718**
Developed						
End of 1983	322	189	43	97	28	679
End of 1984	386	176	37	88	27	714
End of 1985	373	194	36	84	36	723
End of 1986	**280**	**176**	**28**	**61**	**30**	**575**

- "Proved reserves" are those quantities of crude oil, natural gas liquids and natural gas which, upon analysis of geological and engineering data, appear with reasonable certainty to be recoverable in the future from known oil and gas reservoirs under existing economic and operating conditions. As additional information becomes available or conditions change, proved reserve estimates must be revised.
- "Developed reserves" are those portions of proved crude oil, natural gas liquids and natural gas reserves that are recoverable through existing well bores and production equipment and facilities.
- Extensions and discoveries and sales of reserves in place in Other Europe for 1986 include 85 million barrels for crude oil reserves in the United Kingdom which were added and sold during the year.
- "Proved crude oil" excludes reserves attributable to a long-term supply agreement. These reserves are located only in "Other Areas" and at the end of 1986, 1985 and 1984 were seven, nine and four million barrels, respectively. Quantities received during 1986, 1985 and 1984 were 1,689,000, 1,643,000 and 220,000 barrels, respectively.

Years Ended December 31	Natural Gas — Billions of Cubic Feet				
	United States	Norway	Other Europe	Other Areas	Total
Developed and Undeveloped					
End of 1983	3,416	1,749	182	284	5,631
Revisions of previous estimates	167	39	13	(6)	213
Purchases of reserves in place	434	—	109	1	544
Extensions and discoveries	196	—	—	5	201
Production	(286)	(154)	(23)	(10)	(473)
Sales of reserves in place	(2)	—	—	—	(2)
End of 1984	3,925	1,634	281	274	6,114
Revisions of previous estimates	(27)	(644)	23	(42)	(690)
Extensions and discoveries	57	—	53	37	147
Production	(322)	(128)	(26)	(11)	(487)
Sales of reserves in place	(53)	—	(148)	—	(201)
End of 1985	3,580	862	183	258	4,883
Revisions of previous estimates	(93)	542	(66)	29	412
Extensions and discoveries	67	—	357	5	429
Production	(283)	(91)	(17)	(10)	(401)
Sales of reserves in place	(39)	—	(140)	—	(179)
End of 1986	**3,232**	**1,313**	**317**	**282**	**5,144**
Developed					
End of 1983	3,241	1,732	182	269	5,424
End of 1984	3,596	1,634	246	258	5,734
End of 1985	3,292	825	177	209	4,503
End of 1986	**3,020**	**1,252**	**74**	**202**	**4,548**

- The 1985 revisions of previous estimates in Norway reserves were the result of the gas-reinjection program to reduce the rate of subsidence in the Ekofisk field in the Norwegian North Sea. The 1986 revisions are the result of reducing the gas-reinjection program.
- Extensions and discoveries and sales of reserves in place in Other Europe for 1986 include 140 billion cubic feet for natural gas reserves in the United Kingdom which were added and sold during the year.
- "Natural gas reserves" are computed at 14.65 pounds per square inch absolute and 60° Fahrenheit.

Years Ended December 31	Natural Gas Liquids			
	Millions of Barrels			
	United States	Norway	Other Areas	Total
Developed and Undeveloped				
End of 1983	144	50	1	195
Revisions of previous estimates	(3)	3	—	—
Extensions and discoveries	1	—	—	1
Production	(13)	(4)	—	(17)
End of 1984	129	49	1	179
Revisions of previous estimates	(8)	7	—	(1)
Extensions and discoveries	1	—	—	1
Production	(12)	(5)	—	(17)
End of 1985	110	51	1	162
Revisions of previous estimates	43	(5)	—	38
Extensions and discoveries	2	—	—	2
Production	(14)	(3)	—	(17)
End of 1986	**141**	**43**	**1**	**185**
Developed				
End of 1983	140	50	1	191
End of 1984	129	49	1	179
End of 1985	109	51	1	161
End of 1986	**141**	**41**	**1**	**183**

Capitalized Costs

At December 31	Millions of Dollars	
	1986	1985
Proved properties	**$7,989**	8,211
Unproved properties	**809**	1,184
	8,798	9,395
Accumulated depreciation, depletion and amortization	**3,776**	3,413
	$5,022	5,982

- "Capitalized costs" includes the cost of equipment and facilities that support only oil and gas producing activities. Not included are investments in natural gas liquids extraction plants and related systems, as well as downstream manufacturing, distribution and marketing facilities.
- "Proved properties" includes capitalized costs for oil and gas leaseholds holding proved reserves, wells and related equipment and facilities (including uncompleted well costs) and support equipment.
- "Unproved properties" includes capitalized costs for oil and gas leaseholds under exploration, including those where petroleum liquids and natural gas were found but not in quantities to be considered proved reserves.

Costs Incurred

	Millions of Dollars			
	Acquisition	Exploration	Development	Total
1986				
United States	**$ 13**	**130**	**166**	**309**
Norway	**—**	**5**	**87**	**92**
Other Europe	**—**	**30**	**5**	**35**
Africa	**2**	**6**	**9**	**17**
Other areas	**1**	**18**	**13**	**32**
	$ 16	**189**	**280**	**485**
1985				
United States	$ 25	234	348	607
Norway	—	14	107	121
Other Europe	—	48	16	64
Africa	—	15	19	34
Other areas	2	54	11	67
	$ 27	365	501	893
1984				
United States	$1,570	317	284	2,171
Norway	—	26	86	112
Other Europe	106	51	12	169
Africa	7	20	41	68
Other areas	14	55	8	77
	$1,697	469	431	2,597

- "Costs incurred" includes both capitalized and expensed items.
- "Acquisition" includes the costs of acquiring undeveloped oil and gas leaseholds. In 1984 it also includes proved properties of approximately $1.2 billion in the United States and approximately $110 million in the remaining areas resulting from the acquisition of Aminoil.
- "Exploration" includes geological and geophysical expenses, cost of carrying and retaining undeveloped leaseholds, and exploratory drilling costs.
- "Development" includes the cost of drilling and equipping development wells and building related production facilities for extracting, treating, gathering and storing petroleum liquids and natural gas.

Statistics

Net Crude Oil and Natural Gas Liquids Production	1986	1985	1984
	Thousands of Barrels Daily		
Crude Oil			
United States	**124**	154	136
Norway	**52**	63	72
Other Europe	**23**	24	24
Africa	**29**	32	28
Other areas	**10**	8	8
	238	281	268
Natural Gas Liquids			
United States Plant			
Production from leasehold gas	**36**	31	33
Production from purchased gas	**156**	161	147
	192	192	180
Norway production from leasehold gas	**10**	12	12
	202	204	192
	440	485	460

Net Natural Gas Production			
	Millions of Cubic Feet Daily		
United States	**820**	876	843
Norway	**217**	327	364
Other Europe	**54**	72	62
Other areas	**29**	31	19
	1,120	1,306	1,288

Average Sales Prices	1986	1985	1984
Crude Oil—Per Barrel			
United States	**$13.83**	24.56	26.25
Norway	**14.98**	27.55	29.44
Other Europe	**15.09**	27.79	29.20
Africa	**14.04**	27.72	28.93
Other areas	**10.02**	15.13	24.43
Natural Gas Liquids—Per Barrel			
United States	**7.89**	13.13	14.80
Norway	**14.11**	15.03	13.74
Other Europe	**16.04**	24.27	25.62
Natural Gas—Per Thousand Cubic Feet			
United States lease	**1.64**	2.06	1.94
United States lease and natural gas liquids plant*	**1.70**	2.23	2.31
Norway	**4.72**	4.30	4.02
Other Europe	**1.37**	1.69	1.29
Other areas	**1.38**	1.68	1.87

**Excludes sales of liquefied natural gas from Kenai, Alaska.*

Average Production (Lifting) Costs*—Per Equivalent Barrel of Oil	1986	1985	1984
United States	**$4.88**	7.11	6.58
Norway	**7.07**	4.82	4.58
Other Europe	**2.16**	1.97	2.02
Africa	**5.87**	5.57	7.39
Other areas	**3.55**	5.20	10.01

**"Production (lifting) costs" consists of costs incurred to operate and maintain wells and related equipment and facilities used in the production of petroleum liquids and natural gas. Also included is the U.S. crude oil excise tax of $13, $127 and $137 million in 1986, 1985 and 1984, respectively. It does not include depreciation, depletion and amortization of capitalized acquisition, exploration and development costs.*

Acreage at December 31, 1986	Thousands of Acres	
	Gross	Net
Developed		
United States	**2,566**	**1,697**
Norway	**94**	**23**
Other Europe	**13**	**3**
Africa	**109**	**33**
Other areas	**388**	**111**
	3,170	**1,867**
Undeveloped		
United States	**6,429**	**4,129**
Norway	**1,012**	**276**
Other Europe	**3,254**	**917**
Africa	**3,609**	**2,212**
Asia	**2,124**	**889**
Canada	**8,929**	**2,277**
	25,357	**10,700**

Net Wells Completed*	Productive			Dry		
	1986	1985	1984	1986	1985	1984
Exploratory						
United States	**10**	16	18	**22**	43	54
Norway	**—**	—	—	**—**	—	1
Other Europe	**—**	—	—	**1**	2	—
Africa	**—**	—	—	**1**	2	—
Other areas	**2**	—	—	**3**	1	4
	12	16	18	**27**	48	59
Development						
United States	**81**	208	242	**11**	18	27
Norway	**—**	1	1	**—**	—	—
Other Europe	**1**	—	—	**—**	—	—
Africa	**—**	—	2	**—**	—	1
Other areas	**6**	5	19	**1**	2	4
	88	214	264	**12**	20	32

**Excludes farmout arrangements.*

Wells at Year-End 1986

	In Progress*		Productive**			
			Oil		Gas	
	Gross	Net	Gross	Net	Gross	Net
United States	223	62	34,398	7,861	5,563	2,749
Norway	4	1	91	32	34	10
Other Europe	13	4	19	6	34	7
Africa	8	3	206	53	10	2
Other areas	30	11	1,030	367	333	99
	278	81	35,744	8,319	5,974	2,867

**Includes wells which have been temporarily suspended.*
***Includes 1,342 gross and 516 net multiple completion wells.*

Results of Operations

	Millions of Dollars					
	United States	Norway	Other Europe	Africa	Other Areas	Total
1986						
Sales	$ 571	414	129	3	50	1,167
Transfers	582	317	22	139	4	1,064
Total revenues	1,153	731	151	142	54	2,231
Production (lifting) costs	460	256	25	62	20	823
Exploration expenses	101	5	17	7	15	145
Depreciation, depletion, amortization and retirements	732	106	84	128	18	1,068
	(140)	364	25	(55)	1	195
Provision for income taxes	(72)	279	11	53	—	271
Results of operations for producing activities	$ (68)	85	14	(108)	1	(76)
1985						
Sales	$ 977	593	283	26	66	1,945
Transfers	1,112	634	—	301	—	2,047
Total revenues	2,089	1,227	283	327	66	3,992
Production (lifting) costs	772	230	26	65	26	1,119
Exploration expenses	153	11	25	10	28	227
Depreciation, depletion, amortization and retirements	587	139	102	69	22	919
	577	847	130	183	(10)	1,727
Provision for income taxes	260	672	79	201	—	1,212
Results of operations for producing activities	$ 317	175	51	(18)	(10)	515
1984						
Sales	$ 985	622	284	26	89	2,006
Transfers	949	761	—	292	—	2,002
Total revenues	1,934	1,383	284	318	89	4,008
Production (lifting) costs	659	245	25	77	42	1,048
Exploration expenses	196	14	29	11	43	293
Depreciation, depletion, amortization and retirements	518	141	101	53	49	862
	561	983	129	177	(45)	1,805
Provision for income taxes	264	806	107	184	1	1,362
Results of operations for producing activities	$ 297	177	22	(7)	(46)	443

- "Sales" excludes revenues received from operation of natural gas liquids extraction plants and related gas systems. Transfers are valued at prices which approximate market prices.
- "Production (lifting) costs" consists of costs incurred to operate and maintain wells and related equipment and facilities used in the production of petroleum liquids and natural gas. Also included is the U.S. crude oil excise tax of $13, $127 and $137 million in 1986, 1985 and 1984, respectively. It does not include depreciation, depletion and amortization of capitalized acquisition, exploration and development costs.
- "Exploration expenses" primarily includes geological and geophysical expenses and the cost of carrying and retaining undeveloped leaseholds.
- "Provision for income taxes" is computed by adjusting each country's income before income tax for permanent differences related to the oil and gas producing activities that are reflected in the company's consolidated income tax expense for the period and then multiplying the result times the country's statutory tax rate.
- "Results of operations" should not be equated to net income since no deduction has been made for such costs and expenses as distribution, selling, administrative and interest.

Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil and Gas Reserve Quantities

	Millions of Dollars					
	United States	Norway	Other Europe	Africa	Other Areas	Total
1986						
Future cash inflows	**$ 9,137**	**9,634**	**969**	**1,437**	**778**	**21,955**
Future production costs	**(3,136)**	**(3,446)**	**(263)**	**(252)**	**(272)**	**(7,369)**
Future development costs	**(996)**	**(412)**	**(137)**	**(62)**	**(177)**	**(1,784)**
Future income tax provisions	**(1,255)**	**(4,371)**	**(265)**	**(960)**	**(53)**	**(6,904)**
Future net cash flows	**3,750**	**1,405**	**304**	**163**	**276**	**5,898**
10% annual discount	**(1,707)**	**(680)**	**(73)**	**(75)**	**(169)**	**(2,704)**
Discounted future net cash flows	**$ 2,043**	**725**	**231**	**88**	**107**	**3,194**
1985						
Future cash inflows	$18,492	11,142	1,330	2,622	1,463	35,049
Future production costs	(6,642)	(1,982)	(136)	(341)	(576)	(9,677)
Future development costs	(1,513)	(803)	(85)	(74)	(174)	(2,649)
Future income tax provisions	(3,825)	(6,509)	(846)	(1,945)	(263)	(13,388)
Future net cash flows	6,512	1,848	263	262	450	9,335
10% annual discount	(3,289)	(898)	(70)	(93)	(262)	(4,612)
Discounted future net cash flows	$ 3,223	950	193	169	188	4,723
1984						
Future cash inflows	$20,649	13,784	1,560	2,778	1,353	40,124
Future production costs	(7,078)	(2,572)	(173)	(581)	(660)	(11,064)
Future development costs	(2,445)	(942)	(98)	(98)	(100)	(3,683)
Future income tax provisions	(3,833)	(8,102)	(801)	(1,779)	(194)	(14,709)
Future net cash flows	7,293	2,168	488	320	399	10,668
10% annual discount	(3,657)	(986)	(106)	(107)	(211)	(5,067)
Discounted future net cash flows	$ 3,636	1,182	382	213	188	5,601

- "Future net cash flows" is computed using year-end prices and costs and appropriate statutory tax rates that relate to existing proved oil and gas reserves in which the company has mineral interests.

Sources of change in the standardized measure of discounted future net cash flows are as follows:

	Millions of Dollars		
	1986	1985	1984
Revenues less production costs for the year	**$(1,408)**	(2,873)	(2,960)
Net changes in prices and production costs for the year	**(5,313)**	757	(157)
Extensions, discoveries and improved recovery less estimated future costs	**1,019**	258	341
Development costs incurred for the year	**280**	501	431
Purchases of reserves in place less estimated future costs	**—**	—	1,010
Sales of reserves in place less estimated future costs	**(972)**	(554)	—
Revisions of previous quantity estimates and other	**156**	(585)	812
Accretion of discount	**1,188**	1,307	1,236
Net change in income taxes	**3,521**	311	85
	$(1,529)	(878)	798

- "Net changes in prices and production costs" is the beginning of the year reserve quantities multiplied by the net annual change in the per unit sales price and production cost.
- "Purchases and sales of reserves in place, and extensions, discoveries and improved recovery" are production forecasts of the applicable reserve quantities for the year multiplied by the end of the year sales price, less future estimated development and production costs, discounted at 10 percent.
- "Accretion of discount" is 10 percent of prior year's discounted future cash inflows less future production and development costs.
- "Net change in income taxes" is the annual change in the discounted future income tax provisions.

	Millions of Dollars Except as Indicated				
	1986	1985	1984	1983	1982
Selected Income Data					
Sales and other operating revenues	**$ 9,786**	15,636	15,527	15,248	15,697
Income from continuing operations	**234**	596	837	760	701
Net income	**228**	418	810	721	646
Selected Balance Sheet Data					
Current assets	**2,800**	3,144	4,602	2,895	2,900
Properties, plants and equipment (net)	**9,139**	10,281	11,188	9,170	8,165
Total assets	**12,399**	14,045	16,955	13,088	12,073
Current liabilities	**2,231**	3,110	5,345	2,877	2,691
Long-term debt	**5,757**	6,547	2,839	2,242	1,955
Deferred income taxes	**1,685**	1,673	1,433	1,210	838
Redeemable preferred stock	**270**	281	—	—	—
Common stockholders' equity	**1,724**	1,644	6,624	6,149	5,773
Selected Statement of Changes in Financial Position Data					
Funds from continuing operations	**1,263**	2,129	2,233	2,016	1,952
Capital expenditures					
Exploration and Production	**349**	680	747	706	1,080
Gas and Gas Liquids	**89**	136	329	125	240
Petroleum Products	**75**	95	109	126	389
Chemicals	**46**	45	77	64	148
Corporate and Other	**96**	104	106	107	212
Total	**655**	1,060	1,368	1,128	2,069
Purchase of net noncurrent assets of acquired companies	**—**	—	1,784	1,229	—
Dividends paid					
On common stock	**159**	542	362	337	336
On preferred stock	**24**	12	—	—	—
Other Data					
Net income					
As percent of total revenues	**2.3%**	2.6	5.1	4.7	4.1
As percent of average total assets	**1.7%**	2.7	6.0	5.5	5.3
As percent of average common stockholders' equity	**13.5%**	14.7	12.7	12.3	11.6
Percent of long-term debt to capital	**74.3%**	77.3	30.0	26.7	25.3
Current ratio	**1.3**	1.0	.9	1.0	1.1
Per average common share outstanding*					
Income from continuing operations	**$ .91**	2.07	1.81	1.65	1.53
Net income	**$ .89**	1.44	1.75	1.57	1.41
Cash dividends declared	**$ .70**	.95	.78	.73	.73
Common stockholders' equity per share*	**$ 7.55**	7.24	14.28	13.38	12.57
Market price per common share*					
High	**$ 12.63**	17.17	18.75	12.96	13.58
Low	**$ 8.25**	11.00	11.13	9.79	7.83
Close	**$ 11.75**	12.13	14.92	11.50	10.88
Common shares outstanding at year-end (in millions)*	**228.3**	227.1	463.9	459.7	459.4
Common stockholders at year-end (in thousands)	**109.0**	83.3	113.4	119.8	123.1
Total payroll including employee benefits	**$ 1,036**	1,130	1,164	1,192	1,278
Employees at year-end (in thousands)	**21.8**	25.3	29.3	28.4	29.6

**Adjusted for three-for-one stock split in the form of a 200-percent common stock dividend effective May 31, 1985.*

Exploration and Production	1986	1985	1984	1983	1982
	Thousands of Barrels Daily				
Net Crude Oil Production					
United States	**124**	154	136	127	112
Norway	**52**	63	72	81	86
Other Europe	**23**	24	24	5	—
Africa	**29**	32	28	27	26
Canada	**4**	4	4	4	—
Southeast Asia	**1**	—	3	3	1
Latin America	**5**	4	1	—	—
	238	281	268	247	225
Net Natural Gas Liquids Production					
Norway	**10**	12	12	14	12
Gas and Gas Liquids	**192**	192	180	161	148
	202	204	192	175	160
Net Natural Gas Production	Millions of Cubic Feet Daily				
United States	**820**	876	843	799	789
Norway	**217**	327	364	381	404
Other Europe	**54**	72	62	62	67
Canada	**29**	31	19	24	—
	1,120	1,306	1,288	1,266	1,260
Net Oil and Gas Acreage	Millions of Acres				
United States	**6**	7	9	8	8
Europe	**1**	1	2	2	2
Africa	**2**	1	2	2	10
Canada	**3**	4	4	2	2
Southeast Asia	**1**	2	6	7	9
Latin America	**—**	—	1	2	1
Australia and New Zealand	**—**	—	—	1	1
	13	15	24	24	33
Oil and Gas Wells	Net Wells				
United States					
Oil	**7,861**	9,077	9,207	8,210	6,439
Gas and condensate	**2,749**	2,805	2,744	2,573	2,323
Outside United States					
All wells	**576**	542	561	473	132
	11,186	12,424	12,512	11,256	8,894
Well Completions					
United States					
Exploratory	**32**	59	72	51	43
Development	**92**	226	269	203	258
Outside United States					
Exploratory	**7**	5	5	7	20
Development	**8**	8	27	7	5
	139	298	373	268	326

Gas and Gas Liquids (United States)	1986	1985	1984	1983	1982
	Millions of Cubic Feet Daily				
Natural Gas Purchases					
From unaffiliated entities	**1,531**	1,542	1,367	1,222	1,215
From consolidated operations	**395**	378	396	397	388
	1,926	1,920	1,763	1,619	1,603
Natural Gas Processed	**2,041**	2,160	1,858	1,715	1,700
Natural Gas Sales					
Natural gas	**1,009**	1,044	895	756	811
Liquefied natural gas	**96**	101	101	101	96
	1,105	1,145	996	857	907
Net Natural Gas Liquids Plant Production*	Thousands of Barrels Daily				
From leasehold gas	**36**	31	33	27	28
From purchased gas	**156**	161	147	134	120
	192	192	180	161	148

**See Exploration and Production above for total company production.*

Petroleum Products

Refinery Operations					
United States					
Crude oil capacity	**300**	300	295	295	374*
Crude oil runs	**301**	292	288	260	277
Natural gas liquids processing capacity	**223**	223	218	228	228
Natural gas liquids processed	**201**	195	193	187	179

**Includes the 80,000-barrel-a-day Kansas City refinery shut down August 1, 1982.*

Petroleum Products Sold					
United States					
Automotive gasoline	**243**	239	218	212	216
Aviation fuels	**31**	31	26	23	29
Distillates	**93**	91	82	81	77
Liquefied petroleum gas	**99**	108	95	98	108
Other products	**47**	59	35	38	31
	513	528	456	452	461
Outside United States	**41**	47	51	53	52
	554	575	507	505	513
Marketing Outlets (in thousands)	**12**	12	11	12	14

Chemicals					
	Millions of Pounds				
Ethylene sales	**803**	812	481	539	406
Polyethylene sales	**1,410**	1,508	1,358	1,254	1,043

Board of Directors and Principal Officers

As of March 1, 1987

Directors

George B. Beitzel, 58, Senior Vice President and Director of International Business Machines Corporation; Armonk, N.Y. Elected to Phillips board 1980. Also a director of FlightSafety International, Inc., Rohm and Haas Company, Roadway Services, Inc., Bankers Trust New York Corporation and its subsidiary, Bankers Trust Company. (1), (3), (4)

***Michael N. Chetkovich,** 70, Consultant to the Dean and Lecturer at the School of Business Administration, University of California, Berkeley, and former managing partner in the accounting firm of Deloitte Haskins & Sells; Atherton, Calif. Elected to Phillips board 1980. Also a director of American International Group, Inc., and McDonnell Douglas Corporation. (2), (5)

Glenn A. Cox, 57, President and Chief Operating Officer. Elected to Phillips board 1982. Also a director of BancOklahoma Corp. (1)

James B. Edwards, 59, President of the Medical University of South Carolina, former U.S. Secretary of Energy and Governor of South Carolina; Charleston, S.C. Elected to Phillips board 1983. Also a director of J.P. Stevens & Co., Inc., The South Carolina National Bank, Burris Chemical, Inc., Telecommunications Systems, Inc., Brendle's, Inc., SCANA Corporation, Chemical Waste Management, Inc., Encyclopaedia Britannica, Inc., and Imo Delaval Inc. (1), (3), (4)

Robert F. Froehlke, 64, Chairman of the Board of Directors of The Equitable Life Assurance Society of the United States; New York, N.Y. Elected to Phillips board 1984. Also a director of Rexnord, Inc., and Square D Company. (3), (5)

E. Douglas Kenna, 62, Partner of G.L. Ohrstrom & Company, a private investment group; Palm Beach, Fla. Elected to Phillips board 1977. Also a director of Burnley Corporation, Carlisle Corporation, Fleet Financial Group, and Heritage Communications Corporation. (2), (4)

Melvin R. Laird, 64, Senior Counsellor for National and International Affairs for The Reader's Digest Association, Inc.; Washington, D.C. Elected to Phillips board 1976. Former nine-term U.S. Congressman, Secretary of Defense, and Presidential Counsellor. Also a director of Northwest Airlines, Inc., Commercial Credit Company, Metropolitan Life Insurance Company, Science Applications International Corporation, Communications Satellite Corporation, Martin Marietta Corporation, IDS Mutual Fund Group, and Public Oversight Board of the American Institute of Certified Public Accountants. (4), (5)

Carol C. Laise, 69, Former Director General of the U.S. Foreign Service, former Assistant Secretary for Public Affairs in the State Department and former U.S. Ambassador to Nepal; Washington, D.C. Elected to Phillips board 1979. Also a director of the American Security Bank. (2), (5)

David B. Meeker, 61, Former Chairman of the Board of Directors of Hobart Corporation, a manufacturer of food equipment and home appliances; Troy, Ohio. Elected to Phillips board 1976. Also a director of Armco Inc.; Bank One, Dayton, N.A.; Dayton Power and Light Company; J.C. Penney Company, Inc.; Square D Company, and Sterling Drug Inc. (3), (4)

C. J. Silas, 54, Chairman of the Board of Directors and Chief Executive Officer. Elected to Phillips board 1982. Also a director of The First National Bank and Trust Company of Tulsa. (1)

Robert G. Wallace, 60, Executive Vice President. Elected to Phillips board 1982. Also a director of UBT Bancorp, Inc. and its subsidiary, Union Bank and Trust Company, CBI Industries, Inc., and Valmont Industries, Inc.

W. Clarke Wescoe, 66, Retired Chairman of the Board of Directors of Sterling Drug Inc., a diversified pharmaceutical company; Allentown, Pa. Elected to Phillips board 1963. Also a director of The New York Stock Exchange and an advisory director of Irving Bank Corporation and its subsidiary, Irving Trust Company. (1), (2), (3)

Dolores D. Wharton, 59, President of The Fund for Corporate Initiatives, Inc., a nonprofit organization devoted to strengthening the role of minorities and women in the corporate world through professional development and upward mobility programs for younger executives; New York, N.Y. Elected to Phillips board 1976. Also a director of Gannett Co., Inc., Kellogg Company, and Golub Corporation. (3), (5)

Francis M. Wheat, 66, A Senior Partner in the law firm of Gibson, Dunn & Crutcher; Los Angeles, Calif. Elected to Phillips board 1976. (2), (5)

**Mr. Chetkovich retires from the board April 30, 1987.*

(1) Member Executive Committee
(2) Member Audit Committee
(3) Member Compensation Committee
(4) Member Nominating Committee
(5) Member Public Policy Committee

Officers

C. J. Silas, Chairman of the Board of Directors and Chief Executive Officer; officer since 1976.
Glenn A. Cox, President and Chief Operating Officer; officer since 1974.
Leonard M. Rickards, Executive Vice President; officer since 1977.
Robert G. Wallace, Executive Vice President; officer since 1977.
R. E. Bonnell, Senior Vice President Finance; officer since 1978.
William G. Paul, Senior Vice President and General Counsel; officer since 1985.
K. L. Smalley, Senior Vice President; officer since 1980.
Bill M. Thompson, Senior Vice President; officer since 1983.

Other Corporate Officers

W. E. Barr, Vice President Engineering and Procurement
C. L. Bowerman, Vice President Marketing Petroleum Products
J. Thomas Boyd, Vice President Public Affairs
C. F. Cook, Vice President Research and Development
J. W. O'Toole, Vice President and General Tax Officer
Richard I. Robinson, Vice President Refining
John N. Scott, Vice President Federal Relations
Ray G. Steiner, Vice President Supply and Transportation
D. J. Tippeconnic, Vice President Human Resources
J. Bryan Whitworth, Vice President Government Relations
James A. Kelly, Comptroller
J. J. Mulva, Treasurer
Lewis E. Burnham, General Auditor
G. C. Meese, Secretary
J. M. Doyle, Assistant Treasurer
Leonard F. Francis, Assistant General Tax Officer
D. L. Cone, Assistant Secretary
Terry B. Nance, Assistant Secretary

The following changes concerning Phillips management and directors took place or are taking place in the early months of 1987:

- Michael N. Chetkovich, director, will retire from the board April 30, having reached the mandatory retirement age for directors of 70.
- C. M. Kittrell, formerly executive vice president and director, elected to take early retirement, effective March 1.
- Owing to the retirement of C.M. Kittrell, Bill M. Thompson was named senior vice president planning and technology, effective February 1. W.E. Barr, R.E. Bonnell and D.J. Tippeconnic assumed various other responsibilities of Mr. Kittrell. As part of this realignment, Mr. Barr, formerly vice president engineering services, was named vice president engineering and procurement.

These personnel changes took effect during 1986:

- D. J. Tippeconnic, formerly manager Sweeny refinery, was elected vice president human resources, effective June 13.
- W. R. Thomas, formerly vice president human resources, retired June 12.
- J. J. Mulva, formerly assistant treasurer, was elected treasurer June 9.
- Bill M. Thompson, formerly vice president planning and development, was elected senior vice president planning and development June 9.
- James A. Kelly, formerly controller exploration and production, was elected comptroller April 29, effective May 1.
- W. E. Thomas, formerly comptroller, retired April 30.

Stockholder Information

Annual Meeting
Phillips annual meeting of stockholders will be held at 10:00 a.m., April 30, 1987, at the Chicago Hilton Hotel, 720 S. Michigan Ave., Chicago, Ill. Notice of the meeting and proxy material are being sent to all stockholders.

Information Requests
The company welcomes your comments about its operations or any aspect of its business. Please write to one of the addresses below, or contact Phillips investor relations office in New York City (212/397-9766) or Bartlesville (918/661-5139).

Questions regarding stockholder records, stock certificates, dividends or the dividend reinvestment plan should be directed to stockholder records in Bartlesville. Please write to the company's Bartlesville address in care of the stockholder records section, or call toll-free, 1-800-356-0066 (in Oklahoma, 1-800-722-0660).

Form 10-K
Copies of the company's annual report on Form 10-K, as filed with the Securities and Exchange Commission, are available, without charge, by writing to G.C. Meese, Secretary, Phillips Petroleum Company, Bartlesville, Okla. 74004.

Annual Contributions Report
Copies of the company's Annual Contributions Report are also available, without charge, by writing to G.C. Meese.

Principal Offices
Bartlesville, Okla. 74004

630 Fifth Avenue
New York, N.Y. 10111

306 S. State Street
Dover, Del. 19901

Stock Transfer Offices
Manufacturers Hanover Trust Company
Corporate Trust
450 W. 33rd Street
New York, N.Y. 10001

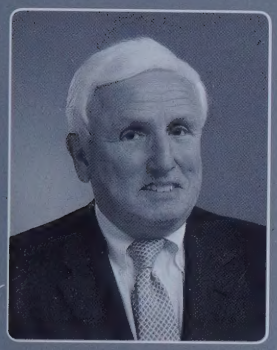
Montreal Trust Company
15 King Street West
Toronto, Ontario
Canada M5H 1B4

Registrars
Manufacturers Hanover Trust Company
Corporate Trust
450 W. 33rd Street
New York, N.Y. 10001

Canada Permanent Trust Company
20 Eglinton Avenue West
Toronto, Ontario
Canada M4R 2E2

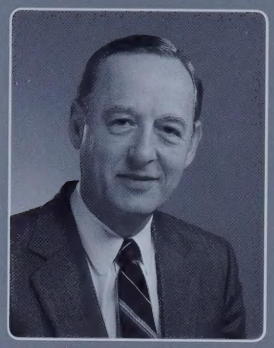
Selected Subsidiaries
Applied Automation Inc.
Phillips 66 Company
Phillips 66 Natural Gas Company
Phillips Driscopipe Inc.
Phillips Fibers Corporation
N.V. Phillips Petroleum Chemicals S.A.
Phillips Petroleum Company Europe-Africa
Phillips Petroleum Company Norway
Phillips Pipe Line Company
Phillips Puerto Rico Core Inc.
Philtankers Inc.
Provesta Corporation

Board of Directors



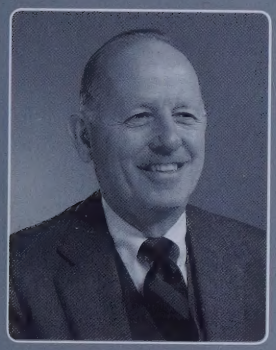
George B. Beitzel

Michael N. Chetkovich



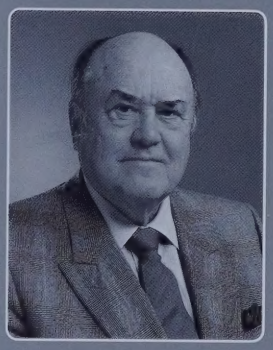
Glenn A. Cox

James B. Edwards



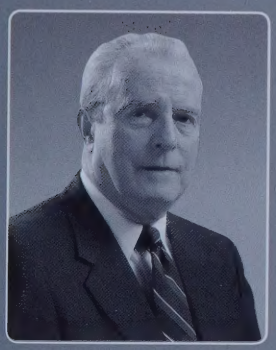
Robert F. Froehlke

E. Douglas Kenna



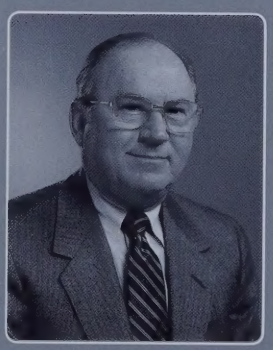
Melvin R. Laird

Carol C. Laise

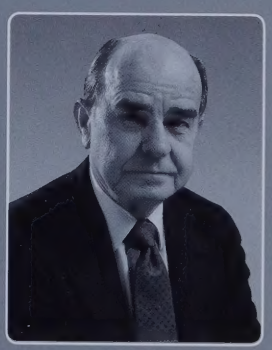


David B. Meeker

C. J. Silas

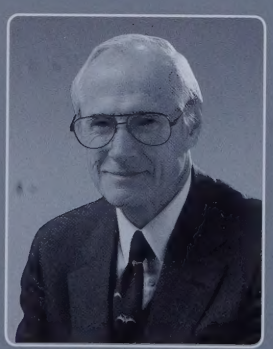


Robert G. Wallace



W. Clarke Wescoe

Dolores D. Wharton



Francis M. Wheat

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